Non-Tariff Barriers After the Tokyo Round

Edited by
John Quinn
and
Philip Slayton

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Proceedings of a conference sponsored by
The Canada – United States Law Institute
London, Ontario 8 – 10 May 1980

The Institute for Research on Public Policy
L'Institut de recherches politiques
Montreal

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Printed in Canada

Legal Deposit Fourth Quarter
Bibliothèque nationale du Québec

Canadian Cataloguing in Publication Data
Main entry under title:
Non-tariff barriers after the Tokyo Round

ISBN 0-920380-61-1

1. Nontariff trade barriers—Congresses. 2. General Agreement on Tariffs and Trade—Congresses. 3. Tokyo Round, 1973–1979—Congresses. I. Quinn, John, 1949–. II. Slayton, Philip. III. Canada–United States Law Institute. IV. Institute for Research on Public Policy.

HF1430.N66 382.9'2 C82-090067-2

The Institute for Research on Public Policy/L'Institut de recherches politiques
2149 Mackay Street, Montreal, Quebec H3G 2J2

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The Canada – United States Law Institute

The Canada – United States Law Institute is an international research and educational organization jointly created by the law schools of Case Western Reserve University in Cleveland, Ohio and the University of Western Ontario in London, Ontario. Since 1976, the Institute has carried on a programme of student and faculty exchanges and has sponsored ten workshops and conferences on legal and economic aspects of Canadian-American relations. In 1978, the Institute commenced publication of the *Canada – United States Law Journal*, an academic review devoted to legal and social scientific analyses of bilateral issues.

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Financial support is provided by the following foundations from both sides of the border: The William H. Donner Foundation (U.S.), The Richard Ivey Foundation (Canada), The Cleveland Foundation (U.S.), The Ontario Bar Foundation (Canada), and the George Gund Foundation (U.S.).

The conference expenses for the Tokyo Round and Non-Tariff Trade Barriers project were funded by a grant from the Social Sciences and Humanities Research Council of Canada.

Foreword

No issue in the international economy today is more important than the proliferation of non-tariff measures, often referred to as the "new protectionism." While in existence for years, these newer forms of protection have rapidly become the centre-piece of international economic policy action and discussion since the elimination, with some significant exceptions, of tariffs as the principal barrier to trade following the Tokyo Round. This series of negotiations, in addition to advancing tariff liberalization, also resulted in international agreement with respect to the use of several major non-tariff barriers and provided the forum for discussion of possible agreement on others, such as safeguards, later.

This volume, the result of a conference held at the University of Western Ontario, attempts to place a particular Canadian perspective on this important international trade issue. It explores both the general economic and political rationale for protectionism in Canada and the United States as well as each of the codes governing the use of specific non-tariff barriers in turn. While no position or positions are advocated, the essays make it quite clear that Canada faces a great challenge this decade both in managing its own non-tariff barriers and in dealing with those of its major trading partners, particularly those of the United States.

As the study of non-tariff barriers is an important part of the International Economics Program of The Institute for Research on Public Policy, this volume will be followed by other studies in the area over the next two or three years.

Gordon Robertson
President
June 1982

Avant-propos

L'économie internationale contemporaine ne connaît aucun problème plus important que celui de la prolifération des mesures non tarifaires, souvent qualifiées de « nouveau protectionnisme ». Bien qu'elles existent depuis nombre d'années, ces nouvelles formes de protection sont rapidement devenues le point de mire des mesures visant l'économie internationale et des discussions à ce sujet depuis l'abolition, sauf quelques exceptions notables, des tarifs comme principaux obstacles au commerce suite à la Ronde Tokyo. Cette série de négociations, en plus de faire progresser la libéralisation des tarifs, a aussi permis d'en arriver à une entente sur le recours à plusieurs importantes barrières non tarifaires et de discuter d'accords éventuels visant d'autres barrières, telles que les sauvegardes.

Ce volume, le fruit d'une conférence tenue à l'université de Western Ontario, tente de placer cette importante question internationale dans une perspective canadienne. On y explore les raisons d'être tant politiques qu'économiques du protectionnisme au Canada et aux États-Unis ainsi que chacun des codes qui régissent le recours à certaines barrières tarifaires. Sans prôner quelque position que ce soit, les textes indiquent clairement que le Canada doit relever un double défi au cours de cette décennie : gérer ses propres barrières non tarifaires tout en composant avec celles de ses principaux partenaires commerciaux, en particulier les États-Unis.

L'étude des barrières non tarifaires constituant une part importante du programme sur l'économie internationale de l'Institut de recherches politiques, d'autres études en la matière suivront au cours des deux ou trois prochaines années.

Gordon Robertson
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Juin 1982

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Introduction

by
John Quinn and Philip Slayton

The Tokyo Round of multilateral trade negotiations was initiated formally on 14 September 1973, when ministers from nearly one hundred nations met in Tokyo and approved a declaration calling for renewed efforts to remove obstacles to international trade.[1] This declaration pledged that participating nations would seek "the expansion and ever-greater liberalization of world trade" through the reduction of tariffs and the reform of national programmes and policies providing unintended or unjustified protection to domestic producers.

The six pre–Tokyo Round sessions of trade negotiations conducted under the auspices of the General Agreement on Tariffs and Trade (GATT)[2] produced substantial reductions in the tariff levels of the developed nations. Some attempts to deal with non-tariff issues were made during the Kennedy Round negotiations of the 1960s; agreement was reached to eliminate the American Selling Price system of customs valuation and a new international Anti-dumping Code was adopted. These limited achievements of the Kennedy Round were later largely nullified by the refusal of the United States Congress to enact legislation implementing the two non-tariff agreements.[3] The Tokyo Round was the first negotiating effort since the origin of the GATT to address the problems of non-tariff measures affecting international trade in a comprehensive way.

The Tokyo Round was conducted during one of the most difficult periods for international economic relations since the Second World War. The 1970s were marked by dramatic increases in energy prices, the sharpest global recession since the 1930s, slow growth and lagging productivity in most of the developed economies, and rampant inflation. These events created serious trade problems for many industries in Europe and North America, and political support for a co-operative approach to international economic problems faltered accordingly. There was a high risk that unilateral protectionist actions would be taken, triggering similar responses from other trading countries.

Despite these obstacles, the Tokyo Round produced a good many complex agreements on tariff and non-tariff measures. Because of the relatively modest size, and eight-year staging, of the agreed tariff cuts, the central achievement of the Round is generally considered to be in the area of non-tariff barriers. Agreements or codes were concluded on the following non-tariff matters:

- Regulation of trade-distortive government subsidies, and rules concerning countervailing duties imposed domestically to offset the effect of such subsidies
- New international rules on "dumping" (sale of goods in an export market at prices below those prevailing in the exporter's home market), through amendment of the existing international Antidumping Code
- Regulation of government procurement practices that distinguish between imports and domestically produced goods
- Rules to establish fairness and equal treatment in the formulation and application of product standards, and related tests and certification procedures
- Rational and uniform methods of appraising the value of imported goods for the purpose of assessing import duties
- Procedures for multilateral consultations and exchanges of information with respect to trade in certain agricultural products, primarily meat and dairy products
- Basic reforms of several other features of the international trading system, such as the elimination of "red tape" and delay in the administration of import licences, and improvements in international legal procedures for settling trade disputes.

These non-tariff agreements are intended to expand the international trading community's control over the policies and programmes of national governments that affect international economic relations. The codes represent an ambitious effort to define which domestic economic measures are legitimate, in view of their international trade repercussions, and which are not. The general aim of the essays in this volume is to examine the structure of this new GATT system for regulation of non-tariff measures, the political and economic goals that animate the provisions of the new codes, and their prospects for fostering a more liberal international economic order.

The essays found here were presented at a conference held at the University of Western Ontario in May 1980. The conference was designed and funded by the Canadian branch of the Canada–United States Law Institute, an independent research and teaching organization sponsored by the Faculty of Law at the University of Western Ontario and the School of Law at Case Western Reserve University in Cleveland, Ohio. Contributors, both Canadian and American, were selected to achieve reasonable balance between academic knowledge and practical experience of commercial policy issues.

When the authors first met, in September 1979, to discuss a research agenda, the Tokyo Round non-tariff codes were barely five months old. The U.S. Trade Agreements Act of 1979[4] had been enacted in late July, but most of the act's major provisions simply mirrored the broad formulations of the non-tariff codes they were designed to implement. New regulations, which would clarify the standards and procedures that U.S. administrators would employ in enforcing the new legislation, had not yet been prepared. Moreover, during the period in which research for these essays was conducted, virtually nothing was known of the Canadian government's plans for legislation and regulations to implement the codes. Many of the participants felt that even if the details of the domestic implementing measures were to become available during the preparation of the essays, little additional knowledge concerning the future impact of the non-tariff codes would be gained through textual analyses of new statutes and regulations. This belief was based, in part, on the fact that most of the codes were designed to be incorporated directly into the domestic law of the signatories. Perhaps more important was the fact that most of the codes focus on the elimination or restriction of domestic policies with protectionist effects, and the codes' contribution to trade liberalization will depend on how the domestic implementing rules are actually administered at the national level.

All the authors felt that a systematic evaluation of the philosphic principles animating the new codes should be the primary aim of their research efforts. Since the codes are directed primarily to the regulation of protectionist policies at the national level, some analytic effort was devoted to evaluating the economic and political determinants of protectionism in Canada and the United States.

GATT After the Tokyo Round

Rodney Grey assesses the Tokyo Round's impact on the evolution of the GATT legal system; his essay was designed, in part, as an introduction to the volume. Grey's main argument is that the Tokyo Round negotiations accomplished very little in dealing with long-term structural problems that have prevented the GATT from evolving into an effective international system for trade regulation. Indeed, Grey's survey of the Tokyo Round agreements suggests that the codes may exacerbate those institutional problems. He expresses considerable anxiety over the failure of the codes to embrace the principle of unconditional, most-favoured-nation treatment, the concept of non-discrimination that underlies the GATT system. He argues that this further dilution in the universality of international trade regulation will encourage a more "power-oriented" system of economic relations, a development that he regards as inimical to the interests of smaller trading nations like Canada. Moreover, Grey argues that the new agreements sanction an undesirable movement away from the GATT's traditional "tariff-centred" commercial policy system and toward a new system of stand-by or "contingent" protection. He believes that this new emphasis on contingency measures will enlarge the discretion of national trade policy administrators, and promote the development of a more restrictive, more protectionist system of world trade regulation. Grey's analysis concludes with a plea for a concerted multilateral effort aimed at strengthening the GATT's organizational structure, especially its processes for dispute resolution.

Rationales for Non-Tariff Intervention in International Trade

Klaus Stegemann surveys the allocative efficiency and distributive consequences of contingency protection. Articles VI and XIX of the GATT[5] recognize as valid certain instruments of contingency protection, such as anti-dumping duties, countervailing duties, and quantitative restrictions; other widely used contingency measures, such as voluntary export restraints and orderly marketing agreements, are not sanctioned by the GATT. Stegemann demonstrates that these measures of contingency protection are inferior, in terms of their impact on national economic welfare, to both subsidies and tariffs as methods of responding to disruptive imports. He also shows that the distributive consequences of contingency measures, subsidies, and tariffs might all be roughly equivalent for the chief beneficiaries of protection, the domestic producers of import-competing products. In the second part of his essay, Stegemann speculates about the reasons for the propensity of representative democracies like Canada and the United States to employ socially wasteful instruments of protection. He develops a theory of imperfect competition applicable to the electoral and legislative processes of democratic political systems in an effort to explain the trade policy preferences of politicians and bureaucrats. Stegemann concludes that contingency measures are preferred over tariffs and subsidies because they reduce the visibility of wealth transfers from consumers to producers, and thus diminish the political risks to the governing party. *Keith Acheson's* comment on the Stegemann essay provides several original extensions and refinements of Stegemann's arguments.

Warren Schwartz analyses the political determinants of trade liberalization. Schwartz focuses on the paradox implicit in Stegemann's model of imperfect political competition: if imperfect competition in the domestic political process biases commercial policy making in favour of protectionist interests, how do international codes regulating non-tariff barriers ever get adopted? Why do politically dominant producer groups permit the adoption of institutional mechanisms designed to reduce their ability to secure greater protection from foreign competition? There is a general tendency for protectionist interests to dominate when trade problems are approached on a case-by-case basis in the domestic political process. Producer interests are concentrated in a few firms while consumer interests are divided among millions; it is easier for producers than for consumers to gather together sufficient resources to have an impact on legislative and administrative decisions. Schwartz argues that trade liberalization has a much better chance when it is approached on a "constitutional basis" through the reciprocal exchange of concessions in an international forum. Negotiations that cover many industries reduce the imbalance between concentrations of producer and consumer interests. An exchange of concessions increases the incentives to organize political coalitions in support of liberalization. Thus, Schwartz argues that GATT bargaining facilitates international "log-rolling." Domestic producers may be willing to permit their government's acceptance of generalized limits on its freedom to restrict imports in return for the acceptance of similar limits by the governments of other countries in which they have export interests. Schwartz's essay also traces out the implications of his international "log-rolling" model for the formal legal structure of non-tariff codes. He argues that the internal dynamics of the bargaining process will result in highly detailed and comprehensive codes of conduct, rather than broader rules of general application. He also notes that the various forms of contingency protection, discussed earlier by Grey and Stegemann, may be favoured by domestic politicians over tariffs and subsidies because they result in wealth transfers to foreign producers. The increased revenues received by foreign exporters are part of the "price" that must be paid for an increase in protection under the non-tariff code regime.

Jean-Luc Migué explores the role of consumers in the formation of domestic political coalitions designed to promote protectionist policies. Migué's main argument is that protectionism, whether implemented by measures aimed at impeding competition in domestic or in international markets, has a tendency to make consumption more uniform than it would be in an unregulated market. Standardization of output results when protectionist policies entail cross-subsidies from low-cost consumers to high-cost consumers; this sort of wealth transfer among subgroups of consumers occurs when trade barriers impose a tax on low-cost imports to expand the market for more costly domestic substitutes. Migué also argues that output standardization is a consequence of protectionist measures that involve price discrimination against consumers with relatively inelastic demand for domestic products. For example, nationalists — those with an inelastic demand for a public good called nationalism — are more easily attracted to coalitions supporting protectionism, and bear a relatively greater proportion of the costs of protection in the form of either high prices or taxes. Through this type of "tied sale," politicians can increase their political support by concentrating the benefits from protection on some consumers while spreading the cost burden more widely on high-demand and low-cost consumers. Migué's model of imperfect political competition demonstrates that certain subgroups of consumers will often receive substantial benefits from trade barriers, and they must be recognized as a source of support for protectionism.

International Regulation of Domestic Commercial Policy

John Barceló provides an analysis of the alternative regulatory strategies available for controlling the international trade effects of domestic subsidy policies. The Tokyo Round Code on Subsidies and Countervailing Duties[6] offers two means of dealing with subsidy-induced distortions: a country may levy traditional countervailing duties to offset foreign subsidies on imported goods, or it may file a complaint with the code's Committee of Signatories seeking modification of the foreign subsidy or a legal right to retaliate through the withdrawal of concessions on exports from the subsidizing country. Barceló concludes that the countervailing duty remedy is inconsistent with both the efficiency and fairness rationales animating most of the GATT rules and standards. He also argues that an international regime of countervailing duties is unlikely to deter harmful or disruptive subsidy policies, and may lead to a less efficient world trading order. Barceló attempts to demonstrate that, by contrast, the code's dispute resolution procedure deals with the genuine issues raised by subsidies, especially those arising from the displacement of exports in third-country markets. For the distinct problem of subsidies that cause disruptive imports, the essay argues that a liberal trading country requires only a single safeguard law, which need not attempt to discriminate among possible reasons for low-priced imports that cause injury to domestic producers. Barceló concludes that the code procedure, authorizing selective retaliation against subsidized imports that cause substantial harm to domestic producers, will serve as an adequate deterrent to the irresponsible use of subsidies by foreign governments.

Stanley Metzger's essay analyses the Tokyo Round amendments to the Anti-dumping Code of 1967,[7] and provisions of the United States' legislation designed to implement the code amendments. Metzger argues that the GATT rules on anti-dumping, as well as the anti-dumping laws of the United States, Canada, and other GATT members, have embodied a "tariff approach" rather than an "antitrust approach" to the regulation of international price discrimination. He demonstrates that the prevailing "tariff approach" to the control of dumping focuses exclusively on injury to domestic producers and ignores the basic objectives of antitrust policy, such as promoting competition and enhancing consumer welfare. Moreover, Metzger argues that the new amendments to the Anti-dumping Code will extend and strengthen the protectionist bias of the GATT scheme of dumping regulation. His essay surveys the various ways in which the code amendments have permitted an intensification of the protectionist effects of the United States' anti-dumping legislation, notably by authorizing weaker causation and injury standards. Metzger concludes that the amended Anti-dumping Code of 1979[8] constitutes "a major backward step" in the direction of increased protectionism.

Armand de Mestral's essay considers the main features of the new Code on Government Procurement,[9] and analyses the code's probable impact on Canadian procurement policies. De Mestral argues that the code represents a departure from protectionism because it challenges the policy, followed hitherto by virtually all trading countries, of excluding foreign suppliers from competition for public-sector contracts. De Mestral is, however, careful not to exaggerate the potential benefits of the code. He points to the code's narrow product market coverage. Most signatories excluded agencies providing utility and transportation services, and all parties insisted on extensive military and national security exemptions. Moreover, service contracts, generally defined as contracts in which substantial quantities of goods are not also exchanged, are also excluded. De Mestral concludes that the code's most significant contribution to liberalization is its detailed procedural rules designed to make tender solicitation and award of government contracts more transparent and susceptible to monitoring by potential foreign suppliers and their governments. He also praises the code's creation of an international Committee of Signatories to administer the agreement, resolve disputes, and provide a permanent framework for further negotiations aimed at expanding the code's coverage of agencies and products.

Ivan Bernier provides a comprehensive assessment of the new GATT Code on Technical Barriers to Trade.[10] Bernier explains the ways in which national product standards designed to regulate the quality or safety of goods may serve, sometimes unintentionally, as a covert type of trade barrier. For example, anti-pollution equipment standards can be written in technical terms, perhaps by prescribing certain design features, which ensure the exclusion of foreign-made automobiles in spite of the fact that the foreign automobiles provide the same emission control performance as domestically produced vehicules. Bernier also argues that national product testing and certification procedures often create unjustifiable barriers to imports. For example, a government standard-setting agency may require that foreign products be tested by domestic authorities to ensure that they conform to national quality and safety standards, and then refuse to certify them or apply more stringent tests than those applicable to domestic products.

Bernier emphasizes the code's procedural approach to regulation of national technical standards; the code does not mandate any specific product standards or testing methods. It establishes a principle of equal treatment for imports and proscribes standards and testing procedures that discriminate "unnecessarily" — those that are not related to any legitimate domestic regulatory objective. Other significant provisions of the code require that signatories provide public notice and opportunities for consultation with respect to product standards and testing methods prior to their promulgation by national standard-setting agencies, that international standards be adopted as the basis for new domestic standards when they are "appropriate," and that foreign testing and certification of conformity with domestic standards be permitted when feasible.

Bernier also analyses several problems that he believes will arise in the implementation of the new code's obligations. Since many standards are set at the state or provincial level, the central governments of federal states may encounter substantial difficulties in policing compliance with their codal commitments. Other problems include the risk that the code's provisions will be circumvented by attempts to draft product standards in terms of production methods or processes rather than design or performance characteristics, and the lack of adequate procedures for safeguarding the confidentiality of proprietary information when products are submitted for foreign testing.

Donald Macdonald focuses on the related problems of private enforcement of national laws implementing the new non-tariff codes, and the appropriate design for government-to-government consultations aimed at resolving disputes arising under the codes. Macdonald's analysis reviews the provisions of the United States' Trade Agreements Act of 1979[11] dealing with government procurement and technical standards. He notes that the United States' implementing legislation permits private parties to initiate either judicial or administrative review of official compliance with codal obligations, to the extent that they are adopted as domestic law. He argues that future Canadian implementing statutes should adopt similar procedural mechanisms for private enforcement. Macdonald then proposes a new bilateral arrangement for Canada–United States disputes under the Tokyo Round codes. He envisages a conciliation tribunal with bilateral representation that would facilitate negotiated settlements by providing careful empirical analyses of disputes and by framing creative proposals for compromise. Macdonald's proposed mechanism incorporates many innovative features, including the right of private parties to initiate the conciliation process.

John Quinn and *Philip Slayton* analyse the primary features of the Customs Valuation Code,[12] which creates a complex set of rules to harmonize divergent national valuation standards and reduce the likelihood of artificially inflated customs appraisals. As with most of the other non-tariff codes, the core problem of customs valuation is administrative discretion; the Valuation Code's key reform is the adoption of a "transaction price" valuation standard designed to constrain the discretionary authority of customs officials to depart from the seller's invoice price in appraising value-for-duty. The code also provides for rigorous and predictable alternative valuation methods for situations in which transaction value would be inappropriate, such as non-arm's-length transactions between a subsidiary and its parent company.

While Canada has postponed implementation of the code until 1984, it is probable that, when fully implemented, the Valuation Code will have a significant liberalizing influence on Canada – United States trade. Quinn and Slayton attempt to show that both Canada and the United States have employed arbitrary and artificially inflated customs valuations as low-visibility administrative barriers to trade. The provisions of the code that are likely to have the greatest significance for Canada – United States trade concern the valuation of goods traded in non-arm's-length transactions; about 50 per cent of Canada – United States trade involves transactions between related buyers and sellers, usually in a parent-subsidiary relationship. The code's provisions governing related party transactions impose limits on the discretion of customs officials to reject reported transfer prices as an acceptable basis for valuation.

Quinn and Slayton also argue that the Valuation Code could be a more effective instrument of trade liberalization if it were expanded to regulate the administrative institutions that almost all trading nations use to enforce their customs laws. Procedural mechanisms greatly influence the allocation of costs between the public enforcement bureaucracy and private traders. For example, a rule imposing the burden of proof on the importer in valuation disputes will reduce public enforcement costs while imposing added costs on importers, who will then increase their efforts to prevent negligent misstatements on customs invoices. This cost-allocating maze of procedural rules provides the "deep structure" of hidden protectionism in customs administration.

Notes

[1] For background on the Tokyo Round, see Alan Wm. Wolff, "The U.S. Mandate for Trade Negotiations," *Virginia Journal of International Law* 16 (1976): 505–64.

[2] General Agreement on Tariffs and Trade, opened for signature 30 October 1947, 61 Stat. A-11, T.I.A.S. No. 1700, 55 U.N.T.S. 194. The current version is contained in 4 General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents (1969).

[3] See R. Baldwin, *Nontariff Distortions of International Trade* (Washington, D.C.: Brookings Institution, 1970), pp. 134–36.

[4] U.S. Trade Agreements Act of 1979, Pub. L. No. 96–39, 93 Stat. 144 (1979) (to be codified in scattered sections of 19 U.S.C.).

[5] GATT, Articles VI and XIX.

[6] Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, GATT Doc. MTN/NTM/W/236. Reprinted in *Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations*, U.S. Congress, H.R. Doc. No. 96–153, Part I, 96th Cong., 1st sess., 1979, p. 257.

[7] Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, *done* 30 June 1967, 19 U.S.T. 4348, T.I.A.S. no 6431.

[8] Agreement on Implementation of Article VI of the GATT. The text referred to is reprinted in H.R. Doc. No. 96–153, Part I, pp. 311 ff. See note 6.

[9] GATT Agreement on Government Procurement, MTN/NTM/W/211/Rev. 2, 12 April 1979, *International Legal Materials* 18 (1979): 1052-78.

[10] GATT Agreement on Technical Barriers to Trade, MTN/NTM/W/192/Rev. 5, 29 March 1979, *International Legal Materials* 18 (1979): 1079-1111.

[11] See note 4.

[12] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, 12 April 1979, MTN/NTM/W/229/Rev. 1.

Introduction

par
John Quinn et Philip Slayton

La Ronde Tokyo de négociations commerciales multilatérales a débuté officiellement le 14 septembre 1973, lorsque les ministres de près de cent pays se sont rencontrés à Tokyo et ont approuvé une déclaration demandant le renouvellement des efforts en vue de retirer les obstacles au commerce international[1]. Cette déclaration engageait les pays participants à promouvoir « l'expansion et la libéralisation toujours plus grandes du commerce international » grâce à la réduction des tarifs et à la réforme des politiques et programmes nationaux qui accordent une protection involontaire ou injustifiée aux producteurs intérieurs.

Les six séances de négociations commerciales préalables à la Ronde Tokyo qui ont eu lieu dans le cadre de l'Accord général sur les tarifs et le commerce (GATT)[2] ont amené des réductions substantielles des niveaux des tarifs dans les pays développés. On a tenté dans une certaine mesure de s'attaquer aux questions non tarifaires au cours de la Ronde Kennedy dans les années 1960; on s'est entendu pour éliminer le régime du American Selling Price en matière d'évaluation douanière et on a adopté un nouveau Code antidumping international. Le refus du Congrès américain d'adopter des lois en vue de donner suite à ces accords non tarifaires est venu annuler dans une grande mesure les réalisations limitées de la Ronde Kennedy[3]. La Ronde Tokyo a constitué le premier effort de négociation, depuis l'origine du GATT, en vue de s'attaquer au problème des mesures non tarifaires affectant le commerce international de manière globale.

La Ronde Tokyo a eu lieu au cours d'une des périodes les plus difficiles pour les relations économiques internationales depuis la Seconde Guerre mondiale. Les années 1970 ont connu des augmentations dramatiques des prix de l'énergie, la plus vive récession mondiale depuis les années 1930, un ralentissement de la croissance et de la productivité dans la plupart des économies développées et une inflation effrénée. Ces événements ont occasionné de graves problèmes commerciaux pour de nombreuses industries en Europe et en Amérique du Nord, et ont entraîné un fléchissement de l'appui politique à une approche coopérative aux problèmes économiques internationaux. On risquait fort de voir se prendre des actions protectionnistes unilatérales susceptibles de susciter des réactions semblables chez les autres partenaires commerciaux.

Malgré ces obstacles, la Ronde Tokyo a permis d'en arriver à un bon nombre d'accords complexes sur les mesures tarifaires et non tarifaires. En raison de l'ampleur relativement modeste et de l'étalement sur huit ans des coupures tarifaires prévues, on considère généralement que c'est dans le domaine des barrières non tarifaires que la Ronde Tokyo a permis d'obtenir les meilleurs résultats. On a conclu des accords ou adopté des codes relativement aux questions non tarifaires suivantes :

- La réglementation des subventions et des règlements gouvernementaux visant les droits compensateurs imposés à l'échelle nationale pour contrebalancer l'effet de tels subsides.
- De nouveaux règlements internationaux sur le « dumping » (la vente de produits sur un marché d'exportation à des prix inférieurs à ceux en vigueur dans le pays d'origine) grâce à des amendements à l'actuel Code antidumping international.
- La réglementation des pratiques d'approvisionnement des gouvernements, pratiques qui distinguent entre les importations et les produits d'origine nationale.
- Des règlements visant à assurer l'équité et le traitement égal dans la formulation et l'application des normes des produits ainsi que des modalités de mise à l'épreuve et de certification connexes.
- Des méthodes rationnelles et uniformes pour l'estimation de la valeur des produits importés en vue d'imposer les droits d'importation.
- Des dispositions visant les consultations multilatérales et les échanges d'information en ce qui a trait au commerce de certains produits agricoles, en particulier la viande et les produits laitiers.
- Des réformes fondamentales de plusieurs autres aspects du régime commercial international, telles que l'élimination de la paperasserie et des délais dans l'administration des permis d'importation ainsi que des améliorations des procédures judiciaires internationales pour le règlement des conflits commerciaux.

Ces accords non tarifaires visent à accroître la maîtrise de la communauté commerciale internationale des politiques et programmes des gouvernements nationaux qui touchent les relations économiques internationales. Les codes représentent un effort ambitieux en vue de déterminer la légitimité des mesures économiques intérieures relativement à leur répercussion commerciale internationale. Les textes présentés dans ce volume cherchent dans l'ensemble à examiner la structure de ce nouveau régime du GATT pour la réglementation des mesures non tarifaires et des objectifs politiques et économiques qui inspirent les dispositions des nouveaux codes ainsi que les perspectives d'en arriver à un ordre économique international plus libéral.

Ces textes ont été présentés lors d'une conférence tenue à l'université de Western Ontario en mai 1980. La conférence avait été organisée et financée par la filiale canadienne du Canada–United States Law Institute, un organisme indépendant de recherche et d'enseignement parrainé par la faculté de droit de l'université de Western Ontario et l'école de droit de la Case Western Reserve University de Cleveland, en Ohio. Les orateurs, tant canadiens qu'américains, ont été choisis dans le but d'atteindre un équilibre raisonnable entre les connaissances universitaires et l'expérience pratique des questions relatives à la politique commerciale.

Lorsque les auteurs se sont rencontrés pour la première fois, en septembre 1979, afin d'établir un ordre du jour pour la recherche, les codes non tarifaires de la Ronde Tokyo avaient à peine cinq mois. Le *Trade Agreements Act* des États-Unis de 1979[4] avait été adopté à la fin juillet, mais la plupart des grandes dispositions de la Loi ne faisaient que refléter les formulations générales des codes non tarifaires auxquels elle devait donner suite. On n'avait pas encore préparé les nouveaux règlements destinés à préciser les normes et les modalités dont devraient s'inspirer les administrateurs américains chargés de faire observer la nouvelle Loi. En outre, alors que s'effectuait la recherche relative à ces textes, on ne connaissait à peu près rien des intentions du gouvernement canadien en matière de lois ou de règlements relativement à ces codes. Plusieurs des participants croyaient que, même si les détails des mesures canadiennes visant à donner suite au code devaient être publiés au cours de la préparation des textes, on n'apprendrait pas grand-chose de plus sur les répercussions futures des codes non tarifaires en étudiant le texte des derniers règlements et des dernières lois. Ce sentiment venait, d'une part, de ce que la plupart des codes étaient conçus de manière à être incorporés aux lois intérieures des pays signataires. Fait encore peut-être plus important, la plupart des codes mettaient l'accent sur l'élimination ou la restriction des politiques intérieures ayant des effets protectionnistes; l'apport des codes à la libéralisation du commerce dépendra de la manière dont seront effectivement administrés, à l'échelon national, les règlements visant à les mettre en vigueur.

Tous les auteurs étaient d'avis qu'une évaluation systématique des principes philosophiques ayant inspiré les nouveaux codes devait constituer l'objectif premier de leurs efforts de recherche. Puisque les codes cherchent avant tout à réglementer les politiques protectionnistes à l'échelon national, on a consacré un certain effort analytique à l'évaluation des déterminants économiques et politiques du protectionnisme au Canada et aux États-Unis.

Le GATT après la Ronde Tokyo

Rodney Grey évalue les effets de la Ronde Tokyo sur l'évolution du régime juridique du GATT; son texte a été conçu, dans une certaine mesure, comme une introduction au volume. Le principal argument de M. Grey veut que les négociations de la Ronde Tokyo n'aient pas fait grand-chose pour régler les problèmes structuraux à long terme qui ont empêché le GATT d'évoluer vers un régime international efficace de relations commerciales. À vrai dire, la recension des accords de la Ronde Tokyo effectuée par M. Grey laisse entendre que les codes pourraient exacerber ces problèmes institutionnels. Le fait que les codes n'adoptent pas le principe du traitement inconditionnel du pays le plus favorisé qui constitue le concept de non-discrimination qui sous-tend tout le régime du GATT suscite chez lui une angoisse considérable. Il soutient que cette dilution encore plus poussée de l'universalité de la réglementation du commerce international favorisera un régime de relations économiques encore plus axé sur le pouvoir, ce qu'il juge contraire aux intérêts des plus petits partenaires commerciaux comme le Canada. En outre, M. Grey prétend que les nouveaux accords sanctionnent un mouvement indésirable du régime de politique commerciale traditionnelle du GATT axé sur les tarifs vers un nouveau régime de protection de relève ou de secours. Il croit que cette nouvelle insistance sur les mesures de secours accroîtra la latitude des administrateurs de la politique commerciale nationale et favorisera l'élaboration d'un régime de réglementation commerciale mondial plus restrictif et plus protectionniste. L'analyse de M. Grey se termine par un plaidoyer en faveur d'un effort multilatéral concerté visant à renforcer la structure organisationnelle du GATT et en particulier ses processus de résolution des conflits.

La raison d'être de l'intervention non tarifaire dans le commerce international

Klaus Stegemann étudie l'efficacité, quant à la répartition, et les conséquences, quant à la distribution, de la protection de secours. Les articles VI et XIX du GATT[5] reconnaissent la validité de certains instruments de protection de secours, tels que les droits antidumping, les droits compensatoires et les restrictions quantitatives; par contre le GATT ne sanctionne pas d'autres mesures de secours fort utilisées, telles que les restrictions volontaires des exportations et les accords sur la commercialisation ordonnée. M. Stegemann démontre que ces mesures de protection de secours sont inférieures, quant à leur influence sur le bien-être économique national, tant aux subventions et aux tarifs qu'aux méthodes de réagir aux importations néfastes. Il démontre aussi que les conséquences en matière de distribution des mesures de secours, des subsides et des tarifs pourraient, en gros, s'équivaloir pour les principaux bénéficiaires de la protection, soit les producteurs nationaux de biens concurrençant les importations. Dans la deuxième partie de son texte, M. Stegemann spécule sur les raisons du penchant qu'ont les démocraties représentatives comme le Canada et les États-Unis pour l'emploi d'instruments de protection constituant un gaspillage du point de vue social. Dans le but d'expliquer les préférences des politiciens et des bureaucrates en matière de politique commerciale, il forge une théorie de la concurrence imparfaite applicable aux processus électoral et législatif des régimes politiques démocratiques. M. Stegemann conclut que les mesures de secours prennent le pas sur les tarifs et les subsides parce qu'elles minimisent la visibilité des transferts de richesses des consommateurs aux producteurs et, par le fait même, font courir de moins grands risques aux partis au pouvoir. Les commentaires de *Keith Acheson* sur le texte de M. Stegemann offrent plusieurs extensions et certains raffinements originaux des arguments de M. Stegemann.

Warren Schwartz analyse les déterminants politiques de la libéralisation des échanges. M. Schwartz s'attaque surtout au paradoxe implicite dans le modèle de concurrence politique imparfaite de M. Stegemann : si la concurrence imparfaite dans le processus politique national fausse l'élaboration de la politique commerciale en faveur des intérêts protectionnistes, comment en arrive-t-on à adopter des codes internationaux réglementant les barrières non tarifaires? Pourquoi les groupes de producteurs, qui dominent sur le plan politique, permettent-ils l'adoption de mécanismes institutionnels destinés à réduire leur aptitude à se garantir davantage de la concurrence étrangère? Dans le cadre du processus politique intérieur, on remarque une tendance générale à la domination des intérêts protectionnistes lorsque l'on aborde les problèmes commerciaux selon une approche individuelle. Les intérêts des producteurs sont concentrés dans quelques entreprises, tandis que ceux des consommateurs se répartissent entre des millions de particuliers; il est plus facile pour les producteurs que pour les transformateurs d'amasser les ressources qui permettent d'influencer les décisions législatives et administratives. M. Schwartz prétend que l'on a de meilleures chances de voir se libéraliser le commerce lorsque l'on aborde cette réforme sur une « base constitutionnelle » par l'entremise d'un échange réciproque de concessions au sein d'un forum international. Les négociations qui visent de nombreuses industries réduisent le déséquilibre entre les concentrations de producteurs et les intérêts des consommateurs. Un échange de concessions encourage les regroupements politiques en faveur de la libéralisation. M. Schwartz soutient donc que les négociations du GATT facilitent les alliances intéressées sur le plan international. Les producteurs nationaux peuvent être enclins à permettre à leur gouvernement d'accepter des limites générales sur sa liberté de restreindre les importations en retour de limites semblables acceptées par les gouvernements d'autres pays vers lesquels ils exportent. Le texte de M. Schwartz relève aussi les implications de ce modèle d'alliance internationale pour la structure juridique officielle des codes non tarifaires. Il prétend que la dynamique interne du processus de négociation donnera des règles de conduite fort détaillées et complètes plutôt que des lignes directrices d'application générale. Il remarque aussi que les politiciens, à l'échelle nationale, pourraient préférer les diverses formes de protection de secours, dont ont déjà traité MM. Grey et Stegemann, aux tarifs et aux subventions, en raison des transferts de richesses aux producteurs étrangers qu'ils occasionnent. L'augmentation des recettes des exportateurs étrangers fait partie du « prix » à payer pour une protection accrue en vertu du régime de codes non tarifaires.

Jean-Luc Migué explore le rôle des consommateurs dans la formation de coalitions politiques nationales visant à faire adopter les politiques protectionnistes. Le principal argument de M. Migué veut que le protectionnisme, qu'il soit le fruit de mesures destinées à nuire à la concurrence sur les marchés intérieurs ou internationaux, ait tendance à rendre la consommation plus uniforme qu'elle ne l'aurait été sur un marché non réglementé. Lorsque des politiques protectionnistes entraînent des subventions compensatoires des consommateurs à faible prix aux consommateurs à prix élevé, on observe une normalisation de la production; ce genre de transfert des richesses entre les sous-groupes de consommateurs survient lorsque les barrières commerciales imposent une taxe aux importations à prix modique de façon à accroître le marché des substituts nationaux plus onéreux. M. Migué soutient aussi que la normalisation de la production est une conséquence de mesures protectionnistes qui comportent une discrimination, en matière de prix, contre les consommateurs ayant une demande relativement inélastique pour des produits intérieurs. Par exemple, les nationalistes — ceux ayant une demande inélastique pour un bien public appelé le nationalisme — sont plus facilement attirés vers des coalitions appuyant le protectionnisme, et supportent une proportion relativement plus élevée des frais de la protection sous la forme soit de prix élevés ou de taxes. Grâce à ce genre de « vente liée », les politiciens peuvent augmenter leur appui politique en concentrant les avantages de la protection sur certains consommateurs tout en répartissant plus globalement le fardeau des coûts sur les consommateurs à forte demande et à faible prix. Le modèle de concurrence politique imparfaite de M. Migué démontre que certains sous-groupes de consommateurs recevront souvent des avantages substantiels des barrières non tarifaires et qu'ils doivent être considérés comme une source d'appui au protectionnisme.

La réglementation internationale de la politique commerciale intérieure

John Barceló offre une analyse des différentes stratégies de réglementation qui s'offrent pour maîtriser les effets du commerce international sur les politiques de subvention à l'échelle nationale. Le Code sur les subventions et les droits compensatoires[6] de la Ronde Tokyo renferme deux moyens de traiter les distorsions provoquées par les subventions : un pays peut imposer des droits compensatoires classiques pour contrebalancer des subventions étrangères sur les biens importés ou encore déposer une plainte auprès du Comité des signataires du Code afin de faire modifier la subvention étrangère ou d'obtenir le droit légal de riposter grâce au retrait de concessions sur les exportations du pays qui pratique les subventions. M. Barceló conclut que le remède que constituent les droits compensatoires est incompatible tant avec le souci d'efficacité que d'équité qui anime la plupart des règlements et normes du GATT. Il soutient aussi qu'un régime international de droits compensatoires risque de n'avoir aucun effet sur les politiques de subvention nuisibles ou destructives et pourrait même affaiblir l'efficacité de l'ordre commercial international. M. Barceló tente de démontrer que, par contraste, la procédure de règlement des différends du Code aborde les vrais problèmes soulevés par les subventions, et en particulier ceux que provoque le détournement des exportations vers des tierces marchés. Quant au problème distinct des subventions qui occasionnent des importations destructives, le texte soutient qu'un pays commerçant libéral n'a besoin que d'une simple loi de sauvegarde qui n'a pas à chercher à distinguer entre les raisons possibles pour les importations à faible prix qui causent un préjudice aux producteurs nationaux. M. Barceló conclut que la procédure du Code qui permet une riposte sélective contre des importations subventionnées occasionnant un tort substantiel aux producteurs nationaux aura un effet de dissuasion suffisant pour empêcher le recours irresponsable aux subventions par les gouvernements étrangers.

Le texte de *Stanley Metzger* analyse les amendements de la Ronde Tokyo au Code antidumping de 1967[7] et les dispositions des lois américaines destinées à donner suite aux amendements au Code. M. Metzger soutient que les règlements du GATT sur le dumping ainsi que les lois antidumping des États-Unis, du Canada et d'autres membres du GATT témoignent d'une « approche tarifaire » plutôt que d'« une approche anticoalition » à la réglementation de la discrimination des prix sur le plan international. Il démontre que « l'approche tarifaire » au contrôle du dumping, actuellement en vigueur, ne tient compte que du préjudice aux producteurs nationaux et ignore les objectifs fondamentaux d'une politique anticoalition, tels que l'encouragement de la concurrence et l'amélioration du bien-être du consommateur. En outre, M. Metzger prétend que les nouveaux amendements au Code antidumping élargiront et renforceront le préjugé protectionniste du mode de réglementation du dumping du GATT. Son texte étudie les diverses façons par lesquelles des amendements au Code ont permis une intensification des effets protectionnistes des lois américaines antidumping, en permettant notamment un affaiblissement des normes de causation et de préjudice. M. Metzger conclut que le Code antidumping amendé de 1979[8] constitue un « important pas en arrière » vers un accroissement du protectionnisme.

Le texte d'*Armand de Mestral* considère les principaux traits du nouveau Code sur les marchés publics[9] et analyse ses répercussions probables sur les politiques d'achat du Canada. M. de Mestral soutient que le Code représente une dérogation au protectionnisme parce qu'il contredit la politique adoptée jusqu'à ce jour par presque tous les pays commerçants, visant à exclure les fournisseurs étrangers du mécanisme de concurrence pour l'obtention de contrats du secteur public. M. de Mestral prend cependant soin de ne pas exagérer les avantages éventuels du Code. À cet effet, il fait remarquer combien sont restreints les marchés visés par le Code. La plupart des signataires ont exclu les organismes de services publics et de transport, et toutes les parties ont insisté pour obtenir des exemptions assez vastes dans le domaine de la défense et de la sécurité nationale. En outre, les contrats de service, généralement définis comme des contrats dans lesquels des quantités substantielles de produits ne sont pas aussi échangées, sont également exclus. M. de Mestral conclut que la contribution la plus significative du Code à la libéralisation tient en ses règlements de procédure détaillés destinés à rendre plus transparent et susceptible au contrôle, par les fournisseurs étrangers éventuels et leur gouvernement, l'appel d'offres et l'octroi de contrats de l'État. Il vante aussi la création, aux termes du Code, d'un Comité international des signataires pour administrer l'accord, résoudre les différends et fournir un cadre permanent pour des négociations futures destinées à accroître le nombre d'organismes et de produits visés par le Code.

Ivan Bernier présente une évaluation complète du nouveau Code du GATT sur les obstacles techniques au commerce[10]. M. Bernier explique de quelle façon les normes nationales sur les produits, destinées à réglementer la qualité ou la sécurité des biens, peuvent servir, parfois sans qu'on le veuille, de barrière commerciale cachée. Par exemple, les normes sur le matériel antipollution peuvent être rédigées en termes techniques, peut-être en prescrivant certaines particularités de conception, qui garantissent l'exclusion des automobiles étrangères, malgré le fait que ces automobiles offrent le même rendement en termes de contrôle des émissions que les véhicules de production nationale. M. Bernier soutient aussi que les modalités nationales de mise à l'épreuve des produits et de certification imposent souvent des barrières injustifiables aux importations. Par exemple, un organisme de normalisation de l'État peut exiger que les produits étrangers soient mis à l'éssai par des autorités nationales afin de s'assurer qu'ils sont conformes aux normes nationales de qualité et de sécurité, et ensuite refuser de les certifier ou encore leur faire subir des épreuves plus rigoureuses que celles que l'on fait subir aux produits nationaux.

M. Bernier met en relief l'approche axée sur la procédure du Code de la réglementation des normes techniques nationales; le Code ne renferme aucune norme ou méthode d'essai précise. Il établit le principe de traitement égal pour les importations, et interdit des normes et des méthodes d'essai qui font une discrimination « inutile » — c'est-à-dire celles qui n'ont pas de rapport avec un objectif de réglementation intérieur légitime. Les autres dispositions significatives du Code exigent que les signataires publient un avis annonçant des consultations quant aux normes des produits et à leur méthode d'essai avant que celles-ci ne soient promulguées par des organismes nationaux de normalisation, que l'on adopte des normes internationales devant inspirer les nouvelles normes nationales lorsque cela « convient », et que l'on permette, lorsque cela s'avère possible, la mise à l'épreuve et la certification, en conformité avec les normes nationales, à l'étranger.

M. Bernier analyse aussi certains problèmes qui, à son avis, surgiront lors de la mise en vigueur des obligations du nouveau Code. Puisque de nombreuses normes sont établies à l'échelon de l'État ou de la province, les gouvernements centraux des États fédéraux pourront éprouver des difficultés d'importance en voulant faire observer leurs engagements aux termes du Code. On risque aussi d'en voir se dérober aux dispositions du Code en tentant de rédiger des normes sur les produits en termes de méthodes ou de processus de production plutôt qu'en termes de caractéristiques de conception ou de performance, et de faire face à un manque de moyens adéquats pour sauvegarder le caractère confidentiel de l'information exclusive au producteur lorsque les produits sont mis à l'essai à l'étranger.

Donald Macdonald se penche sur les problèmes connexes de l'exécution privée des lois nationales visant à donner suite aux nouveaux codes non tarifaires et sur la structure appropriée des consultations de gouvernement à gouvernement destinées à régler les différends soulevés par l'application des codes. L'analyse de M. Macdonald passe en revue les dispositions du *Trade Agreements*

Act de 1979 aux États-Unis[11] qui portent sur les normes techniques et les achats publics. Il remarque que la Loi américaine permet aux parties privées de demander un examen judiciaire ou administratif de l'observation officielle des obligations du Code dans la mesure où celles-ci ont été intégrées à des lois nationales. Il soutient que les futures lois canadiennes qui donneront suite aux accords devraient renfermer des mécanismes de procédure semblables permettant à des parties privées de faire exécuter la Loi. M. Macdonald propose ensuite de nouveaux mécanismes bilatéraux pour le règlement des différends entre le Canada et les États-Unis relatifs aux codes de la Ronde Tokyo. Il envisage la création d'un tribunal de conciliation à représentation bilatérale qui favoriserait des règlements négociés en permettant de plus grandes analyses empiriques des différends et en formulant des propositions de compromis créatrices. Le mécanisme proposé par M. Macdonald innove à bien des égards, entre autres quant au droit des parties privées de lancer le processus de conciliation.

John Quinn et *Philip Slayton* analysent les traits principaux du Code sur la valeur en douane qui crée un ensemble complexe de règlements destinés à harmoniser les divergences entre les normes nationales sur la valeur en douane et à réduire les possibilités d'évaluation douanière augmentées artificiellement. Comme dans le cas de la plupart des autres codes non tarifaires, le problème central de la valeur en douane est celui de la discrétion administrative; la principale réforme apportée par le Code de la valeur en douane est l'adoption d'un « prix des transactions » relativement aux normes sur la valeur en douane, destiné à restreindre l'autorité discrétionnaire des agents des douanes qui voudraient s'écarter du prix facturé par le vendeur en évaluant la valeur en douane. Le Code prévoit aussi d'autres méthodes d'évaluation rigoureuses et prévisibles pour des situations où la valeur de transaction ne s'applique pas, telles que les transactions avec lien de dépendance entre une filiale et sa société-mère.

Même si le Canada a remis l'adoption du Code à 1984, il est probable que lorsqu'il sera complètement en vigueur, le Code sur la valeur en douane[12] aura un effet sensible de libéralisation sur le commerce entre le Canada et les États-Unis. MM. Quinn et Slayton tentent de démontrer que tant le Canada que les États-Unis ont eu recours à des évaluations douanières gonflées arbitrairement et artificiellement comme barrière commerciale administrative peu visible. Ce sont les dispositions du Code relatives à l'évaluation des biens échangés dans les transactions avec lien de dépendance qui auront la plus grande portée sur le commerce entre le Canada et les États-Unis; environ 50 % du commerce canado-américain comprend des transactions entre vendeur et acheteur qui entretiennent des relations; il s'agit habituellement d'une relation filiale–société-mère. Les dispositions du Code réglementant les transactions entre parties reliées imposent des limites à la discrétion des agents des douanes pour rejeter les prix de transfert déclarés comme méthode d'évaluation acceptable.

MM. Quinn et Slayton soutiennent aussi que le Code sur la valeur en douane pourrait être un instrument de libéralisation commerciale plus efficace s'il était élargi de manière à réglementer les institutions administratives auxquelles ont recours presque tous les pays commerçants pour faire observer leurs lois sur les douanes. Les mécanismes de procédure influencent grandement la répartition des coûts entre la bureaucratie chargée de faire exécuter la loi et les commerçants privés. Par exemple, un règlement imposant le fardeau de la preuve à l'importateur dans les disputes sur la valeur en douane réduirait les frais d'exécution publique tout en imposant des frais supplémentaires aux importateurs, qui s'efforceraient alors davantage de ne pas faire de déclaration inexacte, par négligence, sur les factures douanières. Ce dédale de règlements de procédure en matière de répartition des frais fournit la « structure profonde » du protectionnisme occulte dans l'administration des douanes.

Notes

[1] Pour une documentation sur la Ronde Tokyo, voir Alan Wm. Wolff, « The U.S. Mandate for Trade Negotiations », *Virginia Journal of International Law*, 16 (1976), pp. 505–564.

[2] Accord général sur les tarifs et le commerce, présenté pour signature le 30 octobre 1947, 61 Stat. A–11, T.I.A.S. No. 1700, 55 U.N.T.S. 194. La version actuelle se trouve dans les quatre Accords généraux sur les tarifs et le commerce, les Instruments de base et les Documents choisis (1969).

[3] Voir R. Baldwin, *Nontariff Distortions of International Trade*, Washington, D.C., The Brookings Institution, 1970, pp. 134–136.

[4] U.S. Trade Agreements Act de 1979, Pub. L. No. 96–39, 93 Stat. 144 (1979) (à être codifié dans divers articles de 19 U.S.C.).

[5] GATT, articles VI et XIX.

[6] Accord sur l'interprétation et l'application des articles VI, XVI et XXIII de l'Accord général sur les tarifs et le commerce, GATT Doc. MTN/NTM/W/236. Reproduit dans *Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations*, U.S. Congress, H.R. Doc. No. 96–153, Part I, 96th Cong., 1st sess., 1979, p. 257.

[7] Accord sur l'application de l'article VI de l'Accord général sur les tarifs et le commerce, fait le 30 juin 1967, 19 U.S.T. 4348, T.I.A.S. No. 6431.

[8] Accord sur l'application de l'article VI de l'Accord général sur les tarifs et le commerce. Le texte est repris dans H.R. Doc. No. 96–153, Part I, pp. 311 ssq. Voir la note 6.

[9] GATT Agreement on Government Procurement, MTN/NTM/W/211/Rev. 2, le 12 avril 1979, *International Legal Materials*, 18 (1979), pp. 1052–1078.

[10] GATT Agreement on Technical Barriers to Trade, MTN/NTM/W/192/Rev. 5, le 29 mars 1979, *International Legal Materials*, 18 (1979), pp. 1079–1111.

[11] Voir la note 4.

[12] Accord sur l'application de l'article VII de l'Accord général sur les tarifs et le commerce, le 12 avril 1979, MTN/NTM/W/229/Rev. 1.

Part One

GATT After the Tokyo Round

The General Agreement After the Tokyo Round

1

by
Rodney de C. Grey

Introduction

The purpose of this essay is to set out a series of questions or propositions about the GATT system and how it is likely to evolve now that the Tokyo Round is over, and the agreed results are being taken into domestic law. I shall also try to make some suggestions as to how Canadian interests are likely to be affected by the range of possible developments.

The Tokyo Round agreements are not like the results of the other negotiating conferences convened by the Contracting Parties to the General Agreement on Tariffs and Trade (GATT). The various conferences held since the first Geneva tariff bargaining exercise were, in the main, about the exchange of tariff reductions. They were part of the process by which the industrialized countries around the North Atlantic, plus Japan, negotiated down the high tariffs inherited from the 1930s. This was a technique that enabled countries that wanted to reduce their tariffs to do so in a context that minimized the domestic political risk of such an outward-looking policy: they were paid by other countries with tariff reductions on their exports or potential exports.

Clearly the Tokyo Round was not very much like those earlier tariff negotiations because so much of the negotiating effort, and so much of the substantive result, was about the regulation of trade relations mechanisms other than tariffs. That is not to say that the Tokyo Round did not include important tariff-cutting bargains, but merely that even for a country like Canada, to which the tariffs of other countries do matter, the tariff agreements are not likely to be as important as the parcel of agreements about other matters.

The Tokyo Round, as a set of negotiations, has been compared to the various conferences in which the General Agreement was drafted. It has also been compared to the Review Session of 1955, in which a number of amendments to the General Agreement were drafted; the important ones were the so-called organizational amendments which, had they been given effect by the major trading countries, would have brought into existence an international trade relations regulating body with corporate powers (the Organization for Trade Co-operation). This comparison, in my view, is a bit misleading. True, the first drafting conferences and the Review Session were concerned with writing down rules, and so indeed was much of the Tokyo Round. However, there is a major difference. The earlier GATT rule-making conferences did little more than standardize and modify the long-established language of treaties of friendship, commerce, and navigation. If you want the origins of the General Agreement, you must look initially at the Havana Charter;[1] if you want the origins of the Charter's various provisions, you must study, among other things, the pre-war bilateral trade agreements, in particular, the agreements negotiated in 1935 and 1938 between the United States and Canada, the pre-war agreement between the United States and the United Kingdom (and, for Article XIX, the agreement between the United States and Mexico). For the origins of the language of those treaties, you will have to follow the trail back to the Treaty of Washington and even to Jay's Treaty.

My point is that the General Agreement, as a drafting exercise, took familiar words, familiar propositions, familiar statements of rights and obligations, and codified them into a standard trade relations agreement. But the various Tokyo Round agreements are another matter. They deal in great detail with the application, the procedure, and the substance of what are, in domestic law, enactments in very detailed language.

The precedent, within the GATT system, for this sort of exercise was the drafting of the so-called Anti-dumping Code during the Kennedy Round. That agreement involved the writing of a detailed system of rights and obligations regarding the use of a particular commercial policy mechanism. If you compare it (or the Tokyo Round revision) with the relevant parts of Article VI of the General Agreement, you will see that the Anti-dumping Code was international law making of quite a different order of detail than was the General Agreement itself. The Tokyo Round produced a set of detailed agreements on this model.

When one takes into account the concern of the draftsmen with detail, and then notes that the texts, particularly that of the Subsidies/Countervailing Agreement, are not entirely unambiguous, and that, as I recall the drafting meetings, the ambiguity is clearly not all accidental, one should ask whether it is intended that there be a serious effort to enforce these agreements, or whether, if such a serious effort is to be made, it can be successful.

It is, obviously, too early to say, but, in my view, the Tokyo Round agreements may come to be seen as a last effort to draft an entangling fence around the trade-regulating activities of signatories. Alternatively, it may be the foundation of a new and more detailed structure of international law to regulate trade relations. It may be, too, that some of the Tokyo Round agreements will work well, others less well.

But we are entitled to ask: How did we manage so long without such detailed agreements, if they are now so necessary? Perhaps what we are seeing is just an example of the modern compulsive mass production of international law.[2]

It may be that all this is evidence that the commercial policy order built up so laboriously since President Roosevelt and Cordell Hull launched the "Good Neighbour" policy has collapsed, or is in the process of collapsing. As one writer on international law has observed recently: "It has often been said that an unbounded legislative production is a sure sign of decay of a given legal system."[3]

The grafting of the new Tokyo Round agreements on to the General Agreement has made the whole structure very complicated, indeed so complicated, so detailed, that it will be difficult for anyone, even for the Secretariat, to provide authoritative interpretations of the various provisions, and clearly there is a danger in this development. Nonetheless, I will try to make some preliminary observations about the complex of agreements and the emerging system as I see it, as a way of coming to grips with the new GATT.

A Multi-Tier System

First, it is what Gerard and Victoria Curzon have called a "multi-tier system."[4] A one-tier system is a system of rights and obligations that apply on equal terms and with equal force and relevance between all the signatories. From the beginning, the GATT was not completely "one tier": the European signatories were allowed to maintain discriminatory quantitative restrictions on trade with the dollar area as they dismantled their restrictions *vis-à-vis* each other under the aegis of the Organization for European Economic Cooperation (OEEC). But there were general GATT rules, of a sort, about that, and about the residual so-called "hard-core" restrictions, which were the subject of a decision regarding a "model" waiver under Article XXV. These arrangements helped maintain the facade of adherence to the agreement.[5] Moreover, the GATT was taken as a serious, meaningful set of rights and obligations by those developing countries that were signatories: in this regard the GATT, in its early years, was more nearly a "one-tier" system than at any time since.

A number of major developments altered the "universal" character of the GATT provisions and made it, over time, "multi-tiered." In the developing world, many of the newly independent states acquired GATT rights as successors; their politicians and their officials often had no interest in the GATT, and were not inclined to make it central to their new commercial policies. Instead, they turned to regional preferential arrangements, to special arrangements with the former metropolitan countries (e.g., the Lomé Convention) and, at the broadest international level, to securing the enactment of the General System of Preferences. Domestically, they wished to retain a good deal of freedom to impose import quotas for development purposes as well as for balance-of-payment purposes, and to use their import control regimes as bargaining devices if their exports became the object of restrictions by a developed country, and as mechanisms (for example, by exchange-link arrangements) to subsidize exports.

This mix of motives resulted in the negotiation of the various articles that constitute Part IV of the General Agreement, setting out a number of provisions and special dispensations for developing countries. These articles go a long way toward taking away any rights developed countries might otherwise have under the original GATT as regards the commercial policies of the developing countries. In negotiating the vague rhetoric of Part IV, the developing countries got rid of most of their GATT obligations.[6] Developed countries, meanwhile, focused their commercial policy initiatives, not on the GATT, but on regional preferential arrangements — the European Economic Community (EEC), the European Free Trade Association (EFTA), the industrial, tariff-free agreements between the EFTA countries that did not apply for EEC membership and the EEC, and the Canada–United States Automotive Products Agreement. These brought about tariff changes and other trade-regulating changes obviously much more significant than those produced by the GATT process. These were linked to the GATT by the invocation of Article XXIV, but the links were fairly loose.[7] That article provides special rules regarding customs unions and free-trade areas; it had been drafted, not to allow the camel of European integration into the GATT tent, nor to cover the Lomé Convention, but rather to provide some sort of cover or set of rules for such modest regional proposals as the Central American Free Trade Area.

Thus the GATT was, on the eve of the Tokyo Round, at least four tiered. There were countries between which the first thirty-four articles of the GATT provided the commercial treaty system. There were countries between which free trade area or customs union agreements operated (the Canada–United States Automotive Products Agreement being a special sectoral case). There were the rules as between developed countries that applied the GATT and developing countries operating under Part IV. And there were the developing countries arrangements for trade with other developing countries, with various preferential corridors and regional tariff annexes.

The Tokyo Round has added a new tier — the countries that also apply the new agreements *vis-à-vis* the other signatories of those agreements. (Some of the countries, for some of the new codes, are, of course, developing countries.) This has provided what the Curzons have called "a quantum jump in the non-universality of trade law."[8]

It seems to me that this fracturing or "tiering" of the GATT system is not an attractive development for a small industrialized country heavily dependent on trade; our trade agreement rights have been substantially diminished and more and more countries have, as part of the "tiering" process, adopted tariff preferences against Canadian goods.

Stand-by or Contingent Protection

My second comment on the GATT after the Tokyo Round is that as the new agreements begin to be operational, we will move some distance away from the old tariff-centred commercial policy system and toward a new system of "stand-by" or "contingent" protection. One major premise of the GATT as drafted in 1946 was that, except for agriculture, except for countries with balance-of-payments problems, except for situations where emergency protection was being given to particular industries under Article XIX, the tariff was the device that governments were to use to regulate price competition between imports and domestic production. Having paid the agreed fee at the frontier, the foreign producer had an unlimited right to compete in the domestic market with the domestic producer, short of threatening to cause "serious injury," in the sense of Article XIX. And tariffs — the high tariffs inherited from the 1930s — were to be reduced on a most-favoured-nation basis, and bound against increase. No tariff would be raised, once bound, without going through the gate of re-negotiation, and paying compensation under Articles XIX or XXVIII. That was the premise of the post-war system. True, there were anti-dumping and countervailing duty provisions in the GATT and on the statute books, but they were rarely used, compared, that is, to the years since the Kennedy Round.

It does not seem to have been realized that as tariffs came down, some other devices would have to be used to meet the demands of domestic producers who could make a politically convincing case for protection. Hence the growing emphasis on "fair trade" in the United States, hence the refurbishing of the anti-dumping and countervailing duty provisions in the Trade Act of 1974, and the revision and broadening of the catch-all provisions of section 337 of the Tariff Act of 1930.[9] Given these developments, the commercial policy system of the United States, in particular — but also of the EEC and, in due course, of Canada — will be a system in which the central set of mechanisms for intervention will be "contingency" measures rather than tariff measures.

It is not clear that such a system will provide a more open and more stable trading environment than a system relying on a structure of moderate tariffs, bound against increase. My point here, however, is that the new GATT now sanctions, even makes obligatory, systems centred on the concept of contingency protection. The future work of the GATT will be policing these new agreements about contingency protection, and perhaps their eventual revision, in the light of experience. Though there will still be some high tariffs, the need to conduct comprehensive tariff negotiations and to ensure subsequent tariff-rate stability will no longer be the principal reason for having a GATT.

A Legalistic System

My third comment about the new GATT is how legalistic the new agreements, the GATT procedures, and the GATT presentations are. I use the word "legalistic" in a perjorative sense, to stand for the tendency to prescribe in great detail, to argue fine shades of meaning from ambiguous drafting, to put more of a burden of interpretation on the GATT wording than the negotiated phrases will stand, and so avoid dealing with substance. This mirrors at the level of international law and practice the increasing legalization of trade relations policy at the national level. This tendency is most evident in the evolution of United States legislation, first in the Trade Act of 1974, and then in the Trade Agreements Act of 1979. In part the determination by Congress to write detailed legalistic prescriptions was a reaction against what was perceived to be the unwillingness of the administration, particularly the Treasury, to administer the contingent protection provisions with due diligence. In part it was a natural result of coming to rely more heavily on contingency measures than on a schedule of tariff rates. The draftsmen are driven by the logic of contingent protection to try to write down just when and how such protection is to be available — this in a field of law where it is all in the administration and in the procedures.

We are now faced with an extraordinary volume of United States trade relations law. There is not only the statutory enactments — the Tariff Act of 1930, as amended by the Trade Expansion Act of 1962, the Trade Act of 1974, and now the Trade Agreements Act of 1979 — there is also, given the U.S. judicial practice of taking note of legislative intent — the reports of the House and Senate committees, and the Congressional Records of the floor debate, and the Statements of Administrative Intent. Then there is the mass of subordinate legislation — for example, the rules regarding anti-dumping duties and countervailing duties actions formulated by the International Trade Administration in the Department of Commerce, and the procedural rules of the International Trade Commission. Finally, there are the various cases that have been decided by the courts and that have the force of precedent.

We see at work a sort of circular process in which detailed rewriting of trade relations legislation in the United States, which can be understood best in the light of U.S. politics, brings about an extension and rewriting of the GATT. This new GATT, if we can say that the creation of these new agreements has brought about a new GATT, provides the occasion for yet a further rewriting of domestic law. We, in Canada, are caught up in this process too. Our new trade relations legislation, as proposed in Mr. McEachen's *Discussion Paper*, will clearly be much more detailed, more procedural, than what we have had before;[10] just as the 1967 Anti-dumping Act was a much more detailed enactment than the old so-called "automatic" anti-dumping provisions of the Customs Tariff.

The excessive legalization of the GATT is not only a result of the greater legalization of trade relations policy in the United States. Another influence has been the tendency of the EEC to advance its interests in the Contracting Parties, to protect itself against pressure in the Contracting Parties, by deploying great legal skills in interpretation and in drafting. Given the EEC's great weight in the Contracting Parties, the Commission's style of conducting business has had an influence on how business gets done.

A study of the provisions regarding agricultural subsidies in Article XVI, particularly the provisions in paragraph 3 regarding the concept of an "equitable share of world export trade in that product," of the related paragraphs in the new Subsidies/Countervailing Agreement (paragraph 2 of Article 10), and of the interpretation given these provisions in dispute settlement proceedings, particularly the case involving the complaint by Australia regarding EEC subsidies on exports of sugar,[11] would show fairly clearly the style of the representatives of the Commission in protecting their interests in the GATT system. My point is only that that style has had an impact.

It may be too early to draw any firm conclusion about the effect of this extraordinary legalization and rush into detail of the new GATT. It may be merely a sign that the fragile consensus, as between the major industrialized countries on which the post-war commercial policy system was built and which enabled it to operate, is breaking down. It may be a dimension of, or a result of, the collapse of the Bretton Woods monetary arrangements. It may be due more to political factors, such as the strains created in relations across the Atlantic by the rise of the new Europe as powerful in economic and commercial policy as is the United States, and the strain on both the United States and Europe of trying to work out some rules for living with the Third World, and with the Organization of Petroleum Exporting Countries (OPEC), and with the impact on their markets of Japanese competition.

Canadians played a fairly active part in creating and keeping alive that trans-Atlantic consensus, for a time. The rapport between officials inventing and working economic and trade relations policy, a rapport of the kind that created the GATT, is well shown by Douglas Le Pan's brilliant snapshot of the Canadian-British discussions in "Lord Keynes and the Audit Room Meetings" in his recent memoirs.[12] It is difficult to envisage a Canadian/European discussion of that importance, that relevance, and that frankness taking place now.

International Agreements and National Law

A fourth comment on the evolving GATT system is that the new codes are unusual in international law making in that these detailed provisions are designed to be fully taken into domestic law, and in that the major industrialized countries are indeed proceeding to do so. The United States and the EEC are incorporating (in the United States, by statute; in the EEC, by Commission regulations) much of the precise wording of the agreements. This is in sharp contrast with some other recent examples of purported international rule making. Krystyna Marek notes, as an example, that the 1975 Vienna Convention on the Representation of States in their Relations with International Organizations of a Universal Character was not accepted by any of the states that are hosts for international organizations. Marek comments, ". . . here is a textbook example of a treaty being adopted not only in the absence of a real chance of effectiveness, but in the certainty of ineffectiveness."[13] The new GATT is certainly at the other extreme; throughout the negotiations, the major participants were constantly seeking reassurances that the other major participants would indeed implement the agreements in domestic law.

There was a good deal of scepticism outside Washington as to whether the United States Congress would put into law such important changes as an injury test for countervail for dutiable goods.[14]

This scepticism was related in part to the unwillingness of Congress to implement the Agreement on American Selling Price Valuation after the Kennedy Round, and the failure by the United States fully to implement the Anti-dumping Code. However, during the Tokyo Round, Congress was fully and effectively consulted, and it ought to have been no surprise that the implementing legislation was passed quickly, without publicity, within about three months of the agreements being initialled in Geneva, and within a few days of the signing of the Tariff Protocol. A critic of the new GATT might say that all this was to be expected because so much of the detail of the new agreements (of the Valuation Agreement, for example) merely reflects what Congress wanted to legislate.

I suggest that there is another factor at work. I have already noted that the new GATT agreements sanction the elaboration of the system of contingency protection to replace the tariff-centred system, which had become of less relevance once the Kennedy Round reductions were in effect and once we had all moved to a regime of floating exchange rates. The major trading countries, including Canada, needed to rewrite their contingency systems in order to have an adequate basis in law to deal with the pressures on them for action against imports. How better to approach this task of elaborating the necessary legal basis in domestic law than through international agreements? A curious but important example of the interplay between international agreements and national law was the dispute over the use of the word "material." When the EEC Commission made an issue of the fact that the draft of the United States Trade Agreements Act did not use the adjective "material" to modify the concept "injury," although that word was in the Tokyo Round agreements, they must have known that if Congress agreed to use the word "material," they would define it in a way that would not indicate a high threshold of pain. The definition inserted by Congress is that the term "material injury" means harm that is not "inconsequential, immaterial, or unimportant."[15] This definition is helpful to any group of officials proposing to make extensive use of the anti-dumping system to meet demands for protection. It seems to me that the Commission expects to be invoking their system more frequently in the future, and that they wanted a definition that would make it easier, not more difficult, to take anti-dumping action.

For the record, I would like to say that Canada did not join in pressing the United States to use the word "material" in the legislation. We sensed that the outcome would not be helpful for Canadian export interests, in that any definition might ensure that there would be a low threshold for an injury test.

It is important, in assessing the relevance of these considerations, to keep in mind the perverse result of the drafting of any agreement purporting to regulate the use of some restrictive or protective device. Each important delegation ensures that the agreement incorporates provision for the particular national administrative device important to that delegation. Consequently, it is possible for a country, nominally agreeing to a trade-liberalizing arrangement, to enact a new system that is in fact more trade restrictive, more protectionist, than it had before. Thus the Canadian Anti-dumping Act of 1968 was, in a number of particulars, more protectionist than the previous so-called "automatic" system. It could have been more protectionist still if all the features of the GATT code had been incorporated into the domestic legislation. I have in mind particularly the provisions regarding price undertakings, which, in the Kennedy Round agreement and in the two Tokyo Round agreements, are essentially protectionist provisions. Price undertakings permit a government to negotiate with an exporter to protect a domestic producer, using the threat of exposing that exporter to more detailed investigation as to price and to a full injury inquiry. The use of price undertakings as a central mechanism in the anti-dumping/countervail complex introduces a substantial element of discretion into the system, which will inevitably be deployed to protect domestic producer interests. This example may help to explain why the new GATT agreements, unlike some earlier GATT agreements, are being taken into domestic law without real opposition from protectionist interests.

The Organizational Dilemma

My fifth comment is about what one might call the "organizational dilemma." It is worth recalling that GATT is *not* an organization with a corporate identity, having corporate powers separate from those of the signatories, in the sense that the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD) are. We often speak loosely of the GATT as an organization, and one could make a case that, the International Trade Organization and then the Organization for Trade Co-operation not having been called into existence, the GATT Secretariat and the representatives of the Contracting Parties have, little by little, acquired or seized many of the attributes of corporate organization. But there remain governments that are not prepared to see the GATT acquire real executive power over the conduct of trade relations. Trade policy in most countries is highly politicized; in its minutia it touches different producers, different constituencies, differently — and that makes a whole range of trade policy decisions political, in the sense that monetary policy, for example, is not. Given that the GATT is not and is not likely to be, in a formal sense, an international organization, the question is whether it can continue to be the locus and focus of trade policy discussions between the Contracting Parties. In my view, the present uneasy competition between the United Nations Conference on Trade and Development (UNCTAD), the GATT, and the Organisation for Economic Co-operation and Development (OECD) is not tenable in the longer term.

The GATT was, in a sense, discovered again during the Tokyo Round by the Europeans and by some of the developing countries, but this enthusiasm may be of only short duration. The developing countries have now focused on the problem of "conditional" most-favoured-nation treatment, made an issue by the United States' domestic legal provisions on countervail and procurement. United States legislation restricts the benefits of the new system to the signatories of the agreements; it denies them to other GATT signatories, despite the most-favoured-nation requirements of the GATT. The representatives of developing countries in the GATT have reacted to the proposition that the new agreements apply only between the signatories by proposing that the Contracting Parties, acting for all GATT Contracting Parties, should oversee and control the operations of the committees of signatories which will administer each of the new agreements, and that each of the committees should allow non-signatories as observers. Compromise with the developing countries along these lines is essential if many of them are not to be driven away from the GATT.

There are two views about this aspect of the organizational dilemma. One is that it would be more realistic to accept that the GATT exists primarily for the major industrialized nations (including, of course, the newly industrialized states such as Brazil, India, and certainly Mexico), and that the GATT is only weakened by attempting to accommodate the interests of other developing countries and of non-market-oriented regimes. This was the logic of the Atlantic Council's *GATT Plus*. The other view is that, for the smaller industrial countries, having the developing countries present in the GATT enables the interests of all smaller countries *vis-à-vis* the major powers to be more easily defended. On certain issues, some of the developing countries are allies of the smaller industrialized countries. Moreover, there is the consideration that the GATT is one of the international fora where "bloc" tactics have not yet fully taken over, and thus that it would be in the interests of all of us to try to make this one institution work.

From either view, the present rivalry between the GATT and the UNCTAD is unhealthy and destabilizing.

At the other organizational extremity there is the OECD. Some representatives of some developed countries feel that the OECD, because developing countries are not present, is the right forum in which to evolve a consensus between the industrialized countries. The major industrialized countries do go to Paris rather than Geneva when it suits their particular interest, for example, to discuss the international trade in steel. Clearly, if this becomes an invariable practice, and the GATT becomes merely the office in which to file the contract worked out in Paris, the GATT system would gradually lose its vitality. The invention of the GATT Consultative Group of 18, a sort of informal GATT steering group, was in part designed to provide occasions for discussions between policy officials from capitals. It has yet to firmly establish itself.

The new director-general will be measured by how successful he is in bringing about the re-creation of the GATT as the focal point for trade policy discussion as between the important trading countries. Of course, he can succeed in this only if that is what the important trading countries believe is in their interest.

Dispute Settlement Provisions

I turn, finally, to what must be the critical test of any body of international law: the ability of the system to resolve disputes. Conciliation and dispute settlement provisions are an important part of each of the Tokyo Round agreements. The United States legislation makes it clear that it is intended by Congress that United States rights will be enforced, and that the consultation, conciliation, and dispute settlement mechanisms of the various agreements and of the GATT (Articles XXII and XXIII) are to be used, promptly, by the administration.[16]

It is useful to note how the existing GATT dispute settlement practices have evolved. In the Havana Charter, it was proposed that the International Trade organization or any of its members could refer a question in dispute to the International Court of Justice (ICJ). The drafting of this provision was strongly opposed by France. In the General Agreement, no provision was made for reference to the ICJ, but there were numerous provisions for consultation, for compensatory action, and for consultation and adjudication by the Contracting Parties, particularly if there was "nullification or impairment" in the sense of Article XXIII of any benefit under the agreement by any action of a Contracting Party, whether or not such action was consistent with the GATT.[17]

In the early years of the agreement, disputes were resolved either by asking the director-general to give a ruling, if what was at issue was the meaning of a provision, or by setting up a "working party" of representatives of Contracting Parties, acting as instructed by their governments. Working parties produced negotiated solutions. However, it developed that the larger countries, with their greater resources of personnel, were favoured by the working party system. Accordingly, the "panel" system was created, involving the setting up of *ad hoc* panels of trade policy experts, acting in their personal capacities to try to help resolve such disputes as could not be resolved by consultation. By and large, panels were not asked to make recommendations as to what should be done to settle disputes before them, but merely to find the facts and to say whether or not a party was acting in breach of a GATT rule. Resolution of the dispute was left to the Contracting Parties to settle by negotiation and discussion; this practice recognized the politically charged character of trade policy issues.

This mixed system — consultation, working party or panel, discussion in the Council of Representatives or in the Contracting Parties — has not been an unqualified success. It has not resolved all the issues satisfactorily or even promptly. That is not to say that given the intractability of the subject-matter and its political character, it may not be the best we can do.

During the Tokyo Round, the dispute settlement provisions of each agreement were the subject of intensive discussion, as was the attempt to codify the general dispute settlement procedure. There was a measure of consensus. First, there was a strong disposition to build on existing GATT practice. Secondly, there was little inclination to make recourse to panels automatic or inevitable, although it was accepted that any party to the GATT (or to one of the new agreements) had a right to a panel inquiry, even if the issue might not be one which in the opinion of the other parties lent itself to consideration by a panel. Thirdly, all avenues for settling disputes ought to remain available. For some disputes, a working party might be appropriate. For others, perhaps no resolution was possible, and the most that could be done would be to keep the issue on the agenda of the Council of Representatives. But Contracting Parties wanted to keep the choice of technique for themselves. There was little disposition to codify dispute settlement procedures along the lines suggested by John Jackson in the closing months of the negotiation.[18]

Fourthly, there was some disagreement as to how panels should be constituted. Some delegations wanted a roster of potential panel members, with a strong preference for independent persons such as retired trade policy officials or retired GATT senior secretariat officers. Others preferred that panels be drawn from the stock of representatives of Contracting Parties in Geneva, on grounds of availability and economy. The proponents of the first view, which included the Canadian delegation, were concerned that the representatives of smaller countries, if called to serve on panels involving the interests of the major powers, could be subject to influence, perhaps by pressure on their governments. They believed that this was a real risk, (It is of some interest that the most important recent panel, that considering the complaint of Australia against the EEC regarding the EEC's export subsidy on sugar, was composed of persons drawn from delegations.) There was agreement, however, that GATT panels were the preserve of trade policy experts, and that experts in other areas should be consulted, if necessary, by the panel, but should not be members of panels. Fifthly, there was not complete agreement about the role of the Secretariat. Everyone agreed that the Secretariat should be strengthened but some wanted it strengthened rather more than others. In particular, there is the proposal that the Secretariat have a legal division, to improve its ability to give guidance to delegations as to the meaning of the GATT and of the new agreements and, when called upon, to assist panels. Despite my unease about the excessive legalization of the GATT system, I think it is clear that the GATT does need this sort of additional manpower, although as a study of any panel report will show, a GATT legal adviser will have to formulate his advice carefully.

The Tokyo Round review of the general dispute settlement procedures produced a meagre result, on paper, but it made clear that the system could work well enough if the major trading countries wanted it to work, and that no drafting could ensure that it would work effectively if any of the major trading countries were to find it in their interest in a given case that it not work effectively.

It would be encouraging if one of the two major trading countries — the United States or the EEC — agreed to change some major trade policy practice because of a panel finding. Then it will be clear that the GATT system works.

Recent history is not all that encouraging. I have in mind the dispute over the Domestic International Sales Corporation (DISC) and the related complaints by the United States about certain European tax practices. There was a very long delay in finding and agreeing on the membership of the panel — over two years. In my view, none of the panel reports was fully satisfactory and fully convincing. That is not to say that their findings were incorrect.[19]

The findings have not been accepted by the parties concerned; rather, they have negotiated a temporary settlement within the framework of the Subsidies/Countervailing Agreement. The annex to that agreement refines the "Illustrative List of Export Subsidies" first agreed to in 1960. The annex includes, as item (e), "The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes. . . ." This makes DISC a prohibited practice. But note (2) provides that "Where measures incompatible with the provisions of paragraph (e) exist, and where major practical difficulties stand in the way of the signatory concerned bringing such measures promptly into conformity with the Agreement, the Signatory concerned shall . . . examine methods of bringing these measures into conformity within a reasonable period of time."

So much for the panel on DISC, at least for the time being, although Canadians ought not to complain of this result. Canada is the country most adversely affected by the United States DISC system, but we could not find the courage to complain. We left that to the EEC, and then, at the last moment, "associated" Canada with the complaint.[20]

All this makes clear that GATT dispute settlement is not a matter of mechanisms or rules, but of the will to use the existing arrangements and to accept the result, unless they are clearly faulty.

Conclusion

I stated at the beginning of this essay that my purpose was to set out some questions or propositions about the revised GATT system and how it may operate and evolve. This seemed to me to be a useful way to proceed, because any real judgements about the GATT as we have rewritten it cannot yet be made. We need some years of experience to be able to make a judgement. Clearly, there are reasons why we should not be too confident that the GATT system will be able to protect the interests of the smaller countries. Nor is it clear that the GATT is now about trade liberalization. Rather, it is about trade policy regulation. However, the GATT is what we have, and the alternatives — more OECD, or more UNCTAD, or more anarchy — are not all that attractive. Even if we, in Canada, were to opt for rather more bilateralism, for settling some North American problems here in North America without waiting for global solutions to be worked out in Geneva, even then the GATT would remain very much the centre-piece of the Canadian commercial policy system. That being so, it is in Canada's interest to do what we can to make the system work as well as can be.

Notes

[1] See Analytical Index (Third Revision, March 1970), The Contracting Parties to the GATT (Geneva: 1970), which gives the Havana Charter draft for many GATT provisions.

[2] See Krystyna Marek, "Reflections on Contemporary Law-Making in International Law," in *International Relations in a Changing World* (Geneva: Institut universitaire de hautes études internationales, 1977), p. 367: "The mass production of general rules of international law is a contemporary phenomenon which cannot but strike even the least alert observer of international affairs. It has recently reached a scale unprecedented in history."

[3] *Ibid.*, p. 381.

[4] Gerard Curzon and Victoria Curzon, "The Multi-Tier GATT System," in *The New Economic Nationalism*, A Battelle Conference, edited by Otto Hieronymi (London: Macmillan, 1980), pp. 137–47.

[5] See John H. Jackson, *World Trade and the Law of GATT* (New York: Bobbs-Merrill, 1969), p. 709.

[6] In *GATT Plus*, the Atlantic Council argued the logic of a two-tier system in which the developed countries would accept new, tougher obligations *vis-à-vis* each other, but would not seek to impose them on developing countries.

[7] The Canada–United States Automotive Products Agreement required a waiver (under Article XXV) for the United States from its GATT obligations because the United States accorded Canadian products a tariff preference.

[8] Curzon and Curzon, *op. cit.*, pp. 143–44.

[9] For a discussion of the implications of the various changes in section 337, which deals with certain "unfair" trade practices, see Matthew J. Marks, "Recent Changes in U.S. Import Restrictions," a paper prepared for a conference on international trade law, University of Liège, Belgium, 19 October 1979.

[10] Canada, Department of Finance, *Proposals on Import Policy: A Discussion Paper Proposing Changes to Canadian Import Legislation* (Ottawa: Minister of Supply and Services Canada, 1980).

[11] GATT Document L/4833, 25 October 1979.

[12] Douglas LePan, *Bright Glass of Memory* (Toronto: McGraw-Hill Ryerson, 1979), pp. 53–110.

[13] Marek, *op. cit.*, p. 373.

[14] Curzon and Curzon, *op. cit.* "Only if the United States accepts an "injury" clause will the other delegations sign the code. This is still in considerable doubt because it would imply a change of US law," p. 141.

[15] Trade Agreements Act of 1979, title I, amending section 771 of the Tariff Act of 1930.

[16] Trade Agreements Act of 1979, title IX.

[17] For a concise account of the drafting history, see Jackson, *op. cit.*, pp. 163–87.

[18] See John H. Jackson, "Governmental Disputes in International Trade Relations. A Proposal in the Context of GATT," *Journal of World Trade Law* 13 (1979): 1–21.

[19] For an extensive discussion of the panel's performance in the DISC case, see John H. Jackson, "The Jurisprudence of International Trade: The DISC Case in GATT," *American Journal of International Law* 72 (1978): 747–81.

[20] The comparable negotiated settlement of the U.S. complaints against certain European tax practices is in the second paragraph of note 2 to the Illustrative List.

Part Two

Rationales for Non-Tariff Intervention in International Trade

The Efficiency Rationale of Anti-dumping Policy and Other Measures of Contingency Protection

2

by
Klaus Stegemann*

1. Introduction

The term "contingency protection" will be used in this paper as a collective name for the following forms of government intervention: anti-dumping measures, countervailing duties, and safeguard (escape clause) actions.[1] These types of intervention have in common that the implementation of protective measures is contingent on the occurrence of special circumstances. Among the special circumstances, two tend to be crucial: (1) the competition of foreign suppliers is regarded as "unfair," "abnormal," or "distorted"; and (2) such competition causes or threatens to cause serious injury to domestic production in the importing country.[2] As is well known, the Contracting Parties of the GATT have conceded to each other the right to employ measures of contingency protection under conditions that are laid down in Articles VI and XIX of the General Agreement and in various supplementary agreements. From a legal point of view, the principle of the matter is not in dispute. Each country has the right to defend itself against unfair or abnormal import competition that causes serious injury to domestic production.[3] The Tokyo Round Multilateral Trade Negotiations merely attempted to reach a consensus concerning the interpretation and application of the relevant GATT provisions. As major industrial countries increasingly resorted to non-tariff measures of protection, it became necessary to define more closely the bona fide use of contingency protection. In spite of all the legal refinements, however, the economic efficiency rationale of contingency protection is by no means clear-cut.

Why would it be in the interest of any country to prevent producers in other countries from supplying it with imports that are "abnormally cheap"? This is the fundamental question that we will try to answer in this essay. Of course, there are many sub-questions that have to be answered along the way. How can one distinguish between injury to import-competing domestic producers and injury to the country as a whole? How can one distinguish between imports that benefit the importing country and those that are wasteful? How can one distinguish between efficient forms of government intervention and others that are unnecessarily costly? Fortunately, economists have developed an approach that permits an orderly discussion of these questions; it is called the "domestic distortions approach" for reasons that will soon become apparent. Indeed, section 2 of this paper is simply an application of the domestic distortions approach to the problem of contingency protection. In section 3 we shall review reasons that might explain why governments do not generally employ the most efficient forms of intervention; at the same time it will be demonstrated that public support for the existing measures of contingency protection may depend largely on elements of camouflage hiding the true purpose of such measures.

2. Efficient Policy Intervention in the Presence of Domestic Distortions

A. A Pure Distortion of Domestic Income Distribution

The domestic distortions approach of the economic theory of international trade has demonstrated that intervention in trade is not generally the best way of dealing with a perceived policy problem if that problem is related to a "domestic distortion."[4] In this section, the domestic distortions approach will be applied to three different distortions that commonly occur in the context of contingency protection. While the three types of distortion often occur simultaneously, it is helpful to discuss them separately because each poses a different policy problem. Keeping the three cases separate also has the expositional advantage of allowing progression from a very simple market diagram to more complex situations.

The first case is called a "pure distortion of domestic income distribution" because I am assuming that in this case the sole objective of contingency intervention is to restore the domestic distribution of income that has been disturbed by abnormally cheap imports. "Pure" means that in this case there are no other domestic distortions (such as short-sightedness of domestic buyers) that might justify an intervention as being in the national interest. The "injury" caused by imports is thus assumed to be injury to import-competing domestic producers rather than the economy as a whole. At this point there is no need to discuss the question as to why domestic producers ought to be protected against the loss of income when the loss is caused by unusually cheap imports. It will be more opportune to consider that question in section 3(B) below. The principal purpose of the present subsection is to demonstrate that the common forms of contingency protection are wasteful forms of intervention, as other types of intervention could restore a desired domestic distribution of income at a lower "social cost" (a lower cost to the economy).

The point can be best established with the aid of a simple diagram. Lines *DD'* and *SS'* in Figure 1 represent domestic demand and supply, respectively. Let us assume the good in question is "normally" imported at a given price, OP_1. In a perfect market, price OP_1 also becomes the domestic price. Total domestic consumption at that price is *OB*; domestic producers find it profitable to supply quantity *OA*; and the balance, *AB*, is supplied by imports. Now let us assume the price of imports falls from OP_1 to OP_2. At the lower price, the total quantity demanded increases to *OE*; domestic production is reduced to *OC*; and imports are increased from *AB* to *CE*. The fall in the price of imports leads to a substantial reduction in the domestic producers' total revenue: with the "normal" price, OP_1, the domestic producers' gross revenue is given by the area of rectangle $OAMP_1$; when the import price drops to OP_2, the domestic producers' gross revenue is reduced to the much smaller area of rectangle $OCKP_2$. The reduction in net revenue or "producers' surplus" is measured by the area of the hatched trapezoid P_2KMP_1.[5]

Domestic buyers of the product clearly gain when the price of imports falls. Indeed, buyers gain more than domestic producers lose. In Figure 1, buyers' gains are represented by the area of the longer trapezoid P_2VWP_1. This trapezoid consists of the savings that buyers enjoy because they can purchase the previous quantity (*OB*) at a lower

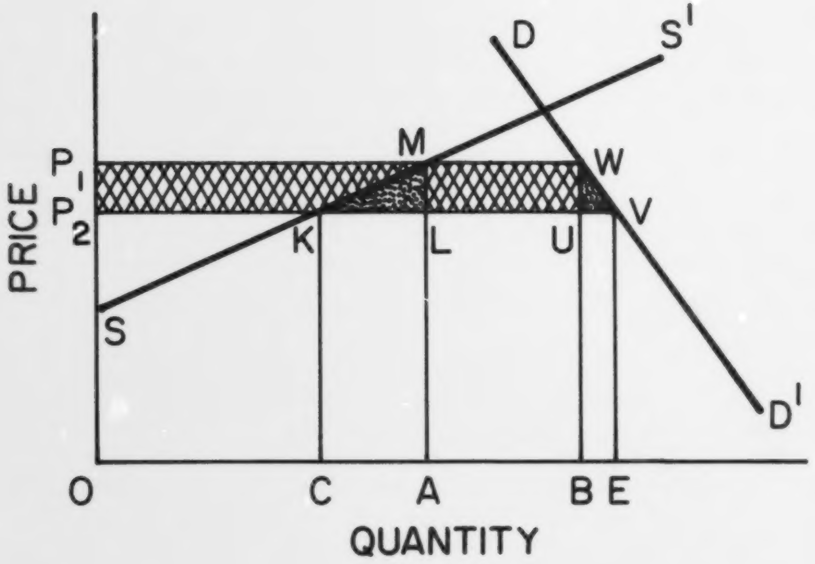


Figure 1

price (area of rectangle P_2UWP_1) as well as consumers' surplus on additional consumption (area of triangle *UVW*).

What about the income of domestic factors of production, such as labour, that are being used to produce the import-competing good? Will factors of production suffer a loss of income when the import price falls? Factor incomes will not be affected for any input that can switch to equally attractive alternative forms of use or employment without even suffering a transitional loss. In other words, factor incomes are not affected to the extent that the import-competing industry employs or buys inputs under conditions of perfectly elastic supply. Such conditions may prevail where an import-competing industry absorbs only a small share of the total supply of an input. Also, the elasticity will be greater the longer the time available for the adjustment of an import-competing industry's employment.

It seems more typical, however, for industries attracting measures of contingency protection to employ at least some important inputs that cannot readily switch to equally remunerative alternatives when producers suffering from import competition reduce their employment. Spatial fragmentation of labour markets, skill differentials, and specialization of human capital will typically result in labour supply being far from perfectly elastic, at least in the short run. Provided input prices are free to adjust in a downward direction, a reduction in demand causes factor prices to fall for inputs that are not hired or purchased under conditions of perfectly elastic supply. A reduction of the import price thus causes a reduction in factor income. More specifically, loss of income occurs because a reduction of input prices reduces the "economic rents" earned by factors of production.

Where are these losses of factor income in our diagram? If input prices are flexible, changes in factor rents are part of the change in producers' surplus. The area of the hatched trapezoid P_2KMP_1 in Figure 1 represents a pure loss of "sellers' surplus" only when the industry is facing perfectly elastic supply curves for all inputs. This means that producers pay the same input prices at output rate *OC* as at output rate *OA*. If the industry pays lower factor prices at the lower level of employment, the hatched trapezoid represents a conglomerate of losses in sellers' surplus and of reductions in factor rents. It seems convenient, therefore, to define producers' surplus in a wider sense, including as producers all owners of inputs affected rather than just the owners of import-competing firms (assets).

There is, however, one other complication that must be pointed out before we proceed with the narrower topic of this subsection. Input prices frequently are not flexible in a downward direction as employers are faced with monopolistic or administrative rigidities. Import-competing producers may be forced to pay the same union wages, or the same minimum wage, or the same administered price for some other input, whether demand for the input is high or low. In such circumstances, the trapezoid of lost producers' surplus (area P_2KMP_1 in Figure 1) would not include reductions in factor rents. Input units that remain employed would not suffer an income loss. Those that are laid off, however, might suffer severely as they might have to take less remunerative jobs or might remain unemployed. Figure 1 does not take into account the case of rigid factor prices. As will be explained in subsection (C) below, with the aid of another diagram (Figure 3), the existence of distorted input prices may require corrective government intervention, not only for distributional reasons, but also for the sake of an efficient allocation of national resources.[6] In the present subsection we shall continue to abstract from domestic price distortions in order to give prominence to the problem of a "pure distortion" of the domestic income distribution.

Let us now assume that a society regards the reduction in domestic producers' revenue as a distortion of the "normal" and accepted domestic distribution of income. As abnormally cheap imports have caused the distortion, the "obvious" route towards restoring the desired distribution of income would appear to be the restoration of the "normal" level of importation. There are several ways of doing this: a tariff could raise the price of imports from OP_2 to OP_1; an import quota could restrict importation to the normal rate, *AB*; "voluntary restraint" agreements with exporting countries could achieve the same effect; finally, anti-dumping or countervailing-duty actions could be employed to raise the price of imports to its normal level if the price reduction was due to foreign dumping or subsidization. Each of these measures could restore the normal distribution of income, meaning that domestic producers would receive gross revenues equal to area $OAMP_1$ in Figure 1, and domestic buyers would pay the equivalent of rectangle $OBWP_1$ for quantity *OB*, as they would with the "normal" price. But each of these measures entails a waste of national resources that could be avoided if importation remained unrestricted.

Before considering alternative types of intervention, let us determine the social cost of restoring the normal domestic distribution of income by means of an ordinary import tariff. When a tariff raises the domestic price from OP_2 to OP_1, it becomes profitable for domestic producers to increase output from *OC* to *OA*, which is regarded as the "normal" rate of domestic production. The effect of the tariff on domestic output is to cause a social cost that is represented by the area of triangle *KLM* in Figure 1. This area represents a social cost of the intervention because it takes more resources to produce quantity *CA* domestically than would be needed to pay for an equivalent quantity of imports. The cost of producing quantity *CA* at home is represented by the corresponding area under the supply curve, which is the area of trapezoid *CAMK*. Without the tariff, quantity *CA* would be acquired by importation at a total cost equal to the area of rectangle *CALK*. Triangle *KLM* thus represents the additional cost to society of producing quantity *CA* at home rather than buying it abroad.[7] The other shaded triangle, *UVW*, represents the social cost that is caused by the effect of the tariff on the rate of domestic consumption. Without the tariff, consumers would purchase an additional quantity *BE*. The social value of the additional consumption can be measured by the area under the demand curve, trapezoid *BEVW*. The social cost of importing quantity *BE* is given by the area of rectangle *BEVU*. Triangle *UVW* thus represents the "dead-weight" loss of consumers' surplus that is caused by the intervention.

The sum of the two shaded triangles in Figure 1 constitutes the total social cost of the tariff intervention (if we ignore the administrative cost of its implementation). The private cost of the tariff to domestic buyers exceeds the social cost as buyers have to pay the higher price, OP_1, for all their purchases, *OB*. The additional private cost that buyers have to bear because of the tariff is represented by two hatched areas in Figure 1: the area of trapezoid P_2KMP_1 represents a transfer of income from domestic buyers to domestic producers, which restores the total net revenue (producers' surplus) that domestic producers obtain at the normal price of imports; the area of rectangle *LUWM* represents the total duty that the government collects on the remaining imports, *AB*. Both areas thus represent domestic transfers of income. They indicate a private cost to buyers but not a social cost to the economy. The shaded triangles, by contrast, indicate the components of the total private cost of the intervention that are also social costs, either because of increased consumption of domestic inputs (triangle *KLM*) or because of consumers' surplus lost (triangle *UVW*).

We started the analysis of this case by assuming that it was the objective of government intervention to restore the "normal" domestic distribution of income. We have now established that the social cost of achieving the stated objective is represented by the two shaded triangles in Figure 1, if the the intervention takes the form of an ordinary import tariff. Indeed, those two triangles of social cost arise also for any other type of intervention that raises the domestic price of imports from OP_2 to OP_1. It has been the crucial contribution of the "domestic distortions approach" to demonstrate that the social cost caused by import restrictions is an unnecessary cost, that is, it is a waste, because other forms of intervention can achieve the same objective without causing the social cost of import restrictions. In the present case, the "distortion" of domestic income distribution that results from the lower price of imports would be best corrected by domestic measures that directly transfer income from buyers to producers without affecting the price of imports. An income subsidy could be used to compensate domestic producers for the loss of net revenue that is caused by cheaper imports (area of the hatched trapezoid P_2KMP_1). The subsidy might be financed by an income or windfall profit tax that absorbs some or all of the gains that buyers obtain when they pay price OP_2 rather than the higher price.[8]

This is not the place to discuss details of domestic measures that might be employed to remove a domestic distortion. The principle of the matter should be clear: the country as a whole can gain, that is, unnecessary social costs can be avoided, if import restrictions are replaced by appropriate domestic forms of income redistribution. As we shall see in section 3, there are reasons, good reasons and bad reasons, why the domestic distortions approach is not generally followed in practice. Meanwhile, it is useful to look more closely at the effects of typical forms of contingency protection, such as import quotas, voluntary export restraints, anti-dumping policies, and countervailing duties. Figure 1 will continue to aid in the analysis.

The effects of an import quota that restricts importation to the "normal" rate, AB, are equivalent to the effects of a tariff, except for the interpretation of the hatched rectangle $LUWM$. With a tariff, as has been pointed out, the rectangle simply represents the total duty collected on the remaining imports. The rectangle thus represents a transfer of income from buyers of imports to the national treasury, and ultimately to other individuals who pay lower taxes or receive higher government benefits. In the case of an import quota, the hatched rectangle represents "quota profits." Such profits accrue to persons or organizations that have permission to import goods that can be acquired at price OP_2 in foreign markets and can be resold in the domestic market at the higher price OP_1. Quota profits thus constitute a domestic transfer of income between consumers and importers provided the imposition of the quota does not lead to an increase in the price at which foreign exporters sell. This condition is likely to be fulfilled in the case of a "global" import quota for a commodity that is supplied by many competing foreign sellers.

The hatched rectangle $LUWM$ does, however, represent a waste of national resources to the extent that foreign suppliers do raise their prices in consequence of the imposition of a quota. This situation is most likely to occur when the import quota is parcelled out to individual supplying countries or when foreign countries have agreed to restrain their exports "voluntarily."[9] Knowing that the bilaterally agreed volume is all they can sell to the importing country, foreign suppliers (frequently at the urging of their governments) increase their export prices to the level at which they can just fill the quota. That price is OP_1 in Figure 1. The area of rectangle $LUWM$ in these circumstances represents a transfer of income to foreign suppliers, that is, a loss of resources from the national point of view, that would not occur without the intervention.[10] If the quota profits go to foreigners, the total waste caused by the quota thus is composed of the two shaded triangles *plus* rectangle *LUWM*.

The same total waste, equal to area *KVWM* in Figure 1, arises if the importing country employs anti-dumping or countervailing-duty measures to restore the "normal" price and the "normal" domestic distribution of income. Anti-dumping and countervailing measures have the effect of forcing foreign suppliers to raise their export prices. Let us first assume that the abnormally low import price was due to dumping. If foreign suppliers must anticipate that the importing country will impose an anti-dumping duty to raise the domestic price of imports from OP_2 to OP_1, they are better off raising their export prices to the "normal" level. Foreign suppliers are better off that way because the effect of the price increase on the volume of their exports is the same in either case, whereas their revenue from the remaining exports is obviously higher with the export price being OP_1 rather than OP_2. The threat of anti-dumping action thus causes a transfer of resources to foreign suppliers (equal to the area of rectangle *LUWM* in Figure 1) in addition to the waste represented by the two shaded triangles that would be caused by any intervention that raises the domestic price of imports from OP_2 to OP_1.[11]

A largely equivalent argument applies to countervailing duties. Let us now assume that the fall in the price of imports from OP_1 to OP_2 was caused by the subsidization of foreign exporting industries. If foreign governments must anticipate that the importing country will react to the subsidization by imposing a countervailing duty that raises the price of imports to the "normal" level, the exporting countries are better off without subsidization.[12] This is so because the volume of exports would be the same in either case, but the revenue received by the exporting countries (or country) is greater without subsidization. With subsidization, the exporting countries would receive price OP_2 per unit and total revenues equal to the area of rectangle *ABUL* for the exports that remain after the countervailing duty has raised the price in the importing country to OP_1. Without subsidization (and without countervailing duty), the exporting countries receive price OP_1 per unit and a total revenue represented by rectangle *ABWM*. If they quit subsidizing, the exporting countries thus gain a transfer of income (resources) equal to the area of the hatched rectangle *LUWM*. The same rectangle, of course, represents a loss of resources that the importing country brings upon itself by forcing exporting countries to abandon subsidization. As in the case of anti-dumping duties, the rectangle represents a reduction of the importing country's national welfare that has to be added to the two shaded triangles of waste that would be caused by any type of import restriction.

The typical forms of contingency protection are thus similar in that they all cause a transfer of income to foreign countries. The transfer is a waste of resources for the importing country, as the transfer (like the triangles of waste) could be avoided if the country would accept the cheaper imports while employing domestic subsidies and taxes to redress changes in domestic income distribution if that is desired. It should be noted that the mechanism by which the hatched rectangle is lost is also quite similar for the different forms of contingency protection: in the case of anti-dumping policies, individual foreign suppliers are discouraged from reducing export prices below some specified "fair value"; countervailing measures *de facto* force foreign countries to abstain from using policies that would reduce export prices; selective import quotas and voluntary export restraint arrangements *de facto* encourage foreign suppliers to raise export prices. Even if a country had reasons to prefer import restrictions to domestic redistribution measures, one would still expect the country to try to acquire the remaining imports at the lowest possible cost. One would, therefore, expect countries to employ ordinary tariffs or global quotas that do not restrict competition among various foreign sources of supply. Why would any government that has a mandate to increase national welfare prefer the described measures of contingency protection? This question will remain with us until section 3.

B. Waste Caused by Domestic Price Distortions: Short-sighted Buyers

In the previous subsection it was assumed that in the face of abnormally cheap imports, the sole objective of government intervention was the removal of a distortion in the domestic distribution of income. The case of a purely restorative intervention is by no means artificial. Under most national laws, the criteria that are applied to determine whether abnormally cheap imports have caused (or are likely to cause) "injury" to domestic production can conceivably be satisfied in circumstances that involve nothing but a loss of income to domestic producers. Anti-dumping measures, for example, might thus be used simply for the purpose of restoring the "normal" income position of income-competing domestic producers at the expense of the rest of the economy.[13] But this is not the way such measures are generally perceived. Producers who suffer a loss of earnings because of abnormally cheap imports are not likely to demand protection simply on the grounds that they deserve a certain "normal" level of income. Politicians who grant protection are not likely either to justify such intervention merely as a means of preserving some traditional domestic income distribution. Producers, politicians, and the public at large will generally claim that restrictions on abnormally cheap imports are needed to protect the welfare of the nation as a whole, rather than just the income positions of particular groups.

The belief that abnormally cheap imports may harm a nation's welfare is generally linked to evidence or allegations of foreign export prices being "distorted," and particularly on evidence that foreign export prices are lower than the foreign "full cost" of production. It will be shown in the following that for abnormally cheap imports to harm the importing country, there must be distortions in its *domestic* market. If buyers of imports are short-sighted or if the prices of import-competing domestic products are distorted (for reasons that have to be explained), government intervention may be required to protect the national interest. It will also be shown, however, that the typical forms of contingency protection are wasteful ways of correcting domestic price distortions. The focus of this subsection will be on problems caused by short-sightedness of domestic buyers; matters of domestic income distribution that have been discussed above will receive only peripheral consideration. As before, the specifics of the argument can best be developed with the aid of a diagram.

Figure 2 repeats the same basic situation that was represented in Figure 1. As in the previous graph, the DD^1 line and the SS^1 line in Figure 2 are the domestic demand and supply curves for some import-competing product. As before, we assume that the normal price of imports is OP_1. At that price, domestic production would be OA, total domestic consumption would equal OB, which implies that imports would equal AB. When the price of imports falls to an abnormally low level, OP_2, domestic production is reduced to OC, consumption is expanded to OE, and imports increase from AB to CE.

In the absence of domestic distortions, the lower price of imports results in a welfare gain to the importing country that is represented by the area of the flat trapezoid $KVWM$ in Figure 2.[14] In the absence of domestic distortions, an abnormally low price of imports is no reason for government intervention, because domestic production and consumption adjust optimally. Without distortions in the domestic market, the domestic rate of production is optimal at OC because for that rate of production, the marginal social cost of acquiring the good by importation equals the marginal social cost of domestic production. Without distortions, the marginal social cost of domestic production is indicated by the height of the SS^1 curve, and the marginal social cost of importation is given by OP_2 (or the height of the horizontal line P_2V). The domestic rate of production is thus optimal at OC, because for that rate the height of the SS^1 curve (CK) equals OP_2. Similarly, the domestic rate of consumption is optimal at OE in the absence of domestic distortions because for that rate of consumption, the marginal social value of the good equals the marginal social cost of acquiring it. The marginal social value of the good is indicated by the height of the DD^1 curve. Consumption rate OE is thus optimal as VE equals OP_2 (and CK). If both domestic production and consumption

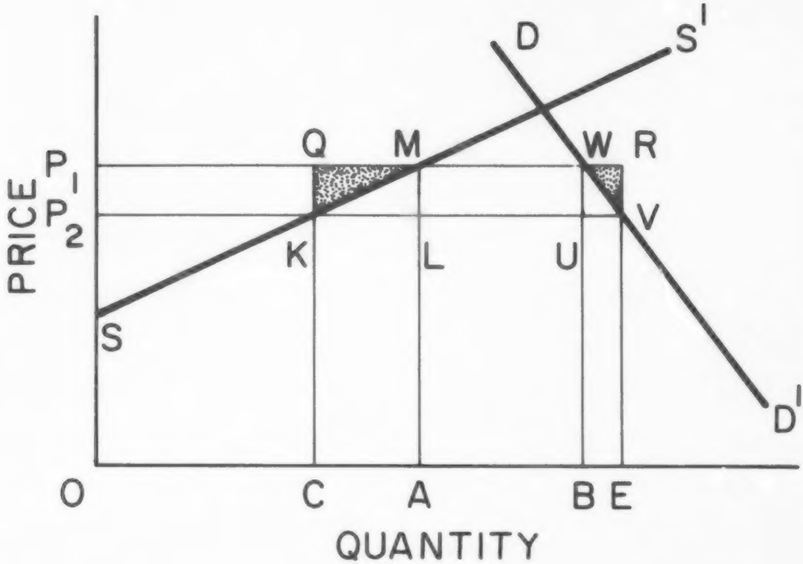


Figure 2

adjust optimally to price OP_2, it follows that the rate of importation, *CE*, is also optimal.[15]

If anyone wishes to argue that, in the situation we have discussed, government intervention is required to achieve an efficient allocation of national resources, there must be a distortion in the *domestic* market. Short-sightedness of domestic buyers is the most common argument used by domestic producers to justify their demands for protection against abnormally cheap imports.[16] Buyers are alleged to be short-sighted in the sense that they disregard or systematically underestimate part of the cost of buying abnormally cheap imports that they (and others) must pay in the future. In the most extreme version of the argument, it is claimed that foreign suppliers lower their prices temporarily for the purpose of eliminating domestic production in the importing country. After such "predatory" pricing has served its purpose, foreign suppliers are predicted to charge prices far in excess of what buyers would have paid for domestic products. In my view, this line of reasoning may be discarded as it is difficult to think of any industry relevant in the context of contingency protection for which foreign suppliers could expect to attain a world monopoly position after they have wiped out the domestic suppliers in a particular importing country. More moderate versions of the argument emphasize the cyclical nature of offshore supply. With reference to past experience, it is pointed out that foreign suppliers who offer to sell at abnormally low prices during periods of slack demand will charge abnormally high prices in boom times — if they are willing to export at all. It is (tacitly) implied that buyers tend to underestimate the higher cost of imports in boom times or that individual buyers discount the cyclical element because they plan to fall back on domestic supplies when the abnormally cheap foreign sources dry up. In either case, it is claimed that government intervention ought to enable domestic producers to maintain sufficient capacity for periods of boom demand and times of emergency.[17]

While the relevant real world conditions are too complex to be fully captured by a static model of a perfectly competitive market, Figure 2 permits a consideration of the principle of this argument for intervention. Let us assume that domestic buyers do, indeed, underestimate the long-run cost of buying abnormally cheap imports. The abnormally low price, OP_2 in Figure 2, that determines the decisions of domestic buyers thus under-represents the social cost of buying abnormally cheap imports. The social cost would have to include the cost of properly discounted future price increases, the extra cost of obtaining service and spare parts for imported equipment, the cost of changing back to domestic supplies, and so forth. To keep the diagram simple, let us assume that the true social cost per unit of imports just happens to be equal to the price of normal imports, OP_1. The divergence between the true marginal social cost of importing and the price that guides the decision of short-sighted domestic buyers leads to a waste of national resources. The total waste is represented by the two shaded triangles in Figure 2.

The area of triangle *KMQ* represents the waste that occurs because short-sighted buyers import quantity *CA*, which could be acquired at a lower social cost if it were produced at home. The social cost of importing quantity *CA* is given by the area of rectangle *CAMQ*. The social cost of producing it at home is represented by the area under the domestic supply curve, *CAMK*. The area of the shaded triangle *KMQ* thus indicates the value of national resources that could be saved if quantity *CA* were produced domestically. The area of the other shaded triangle represents the waste that occurs because buyers are led to consume too much of the deceptively cheap product. More specifically, the social cost of importing quantity *BE* is indicated by the area of rectangle *BERW*. The social value of consuming that same quantity is indicated by the area under the demand curve, *BEVW*. The area of the shaded triangle *VRW* thus represents the value of national resources that is wasted because domestic buyers underestimate the marginal social cost of abnormally cheap imports.

Given that we have assumed the marginal social cost of imports to equal OP_1 (or the height of the horizontal line P_1R), the socially optimal rate of importation is, of course, equal to *AB*. It follows that the optimal rate of domestic production is *OA* and the optimal rate of consumption is *OB*, as would be the case in the absence of abnormally cheap imports.[18] In this situation it would seem obvious that the optimal solution could be attained by policy measures that raise the price of abnormally cheap imports from OP_2 to OP_1. At the higher price, it would appear that domestic buyers being faced with the true marginal social cost of importing could not fail to make socially optimal decisions in spite of being short-sighted. The matter is, however, not that simple.

If the intervention is contingent on abnormal cheapness, measures that threaten to raise the price of imports from OP_2 to OP_1 provide an incentive to foreign suppliers to raise their export prices by that amount. As has been explained in the previous subsection, foreign suppliers who realize that their customers in a certain country must pay price OP_1 in any event collect the price increase themselves rather than let it be collected as a special duty by the treasury of the importing country. If foreign suppliers behave this way, the cost of the remaining imports, *AB*, increases by the area of the familiar rectangle *LUWM*. The intervention does nothing to cure the short-sightedness of domestic buyers, and the intervention does not correct the price distortion if it enables (and even encourages) foreign suppliers to raise their prices. Buyers who remain short-sighted would continue to ignore part of the social cost of importing from unreliable sources that after the intervention must be added to price OP_1. The cost represented by area *LUWM* would thus have to be borne twice: at the time of importing and in the future when the hidden costs have to be paid that supposedly short-sighted buyers tend to overlook. In the case shown by Figure 2, the cure would be worse than the disease, as the area of rectangle *LUWM* is larger than the combined area of the two shaded triangles.

Domestic measures that attack short-sightedness of buyers directly could reduce imports to the socially optimal level while avoiding the additional cost that is caused by foreign suppliers increasing their prices. The government might provide buyers with information that they cannot afford to collect individually; buyers might be required to hold inventories in relation to the reliability of their sources of supply; it might also be feasible to levy an import duty that is related to the short-sightedness of buyers. As long as such measures are not triggered by an abnormal cheapness of imports, they will not cause foreign suppliers to raise their prices.[19] Furthermore, measures that attack short-sightedness directly could be differentiated in accordance with the presumed degree of discrepancy between the private and the social cost of importing. There is no reason why all buyers of a certain product should be equally short-sighted. There is no reason either why the true marginal social cost of importing should just be equal to the normal price (OP_1 in Figure 2). As may be recalled, I have assumed this equality only because it simplifies the diagram.

While procedures implementing measures of contingency protection tend to focus on the normal price of foreign goods, it would be far-fetched to pretend that policy makers regard the normal price as a proxy for the marginal social cost of buying abnormally cheap imports. If short-sightedness of domestic buyers is an important element in the political support for contingency protection, such concern certainly is not reflected by any of the investigation procedures that I am aware of.

Indeed, the short-sightedness of buyers of abnormally cheap imports may be largely a myth. In most cases, buyers of imports are sophisticated businessmen who look beyond the current phase of the market cycle, who are concerned with the long-run cost of their inputs, and who would not wish to put all their eggs in one basket. Private buyers do not, of course, always make the right decisions. Wisdom of hindsight, however, does not prove short-sightedness; and why would anyone assume that governments are less short-sighted and have to intervene to safeguard the interests of private buyers? If domestic producers believe that over the cycle they are a cheaper source than foreign suppliers who quote abnormally low prices during the slump, why are domestic producers unable to convince their customers of this advantage, for example, by offering long-term contracts that foreign suppliers are unwilling to match? If domestic producers are unable to cover their cost over the market cycle without being protected against foreign price cutting during slump periods, why should they be encouraged to maintain their capacity? If, on the other hand, domestic producers do expect to cover their opportunity cost over the cycle, why are they unwilling to maintain or expand their capacity in anticipation of a shortage that they believe to be only a few years away?

Part of the problem could derive from imperfections in the capital market: investors may be short-sighted and are unwilling to lend funds to an industry suffering from a temporary slump.[20] Buyers could also be short-sighted in a different sense: while they are fully aware of the advantages of preserving domestic sources of supply for times of emergency, buyers individually may have little incentive (or none at all) to pay the cost of securing reliable sources of supply. In other words, there may exist a "free-rider" problem.[21] If in times of emergency all buyers can share equally in the purchase of domestic supplies (possibly at government-controlled prices), nobody has an incentive to pay premium prices for the domestic product at times when imports are "abnormally cheap." If domestic producers do not receive the premium, they will not provide the additional capacity that buyers as a group (and their customers, employees, and affected third parties) would be willing to support as emergency insurance.

There might thus be a case for government intervention to secure a sufficient safety margin. It should be reiterated, however, that efficient intervention would not take the form of import restrictions, let alone contingency protection.

Furthermore, it should be noted that government intervention may have created the free-rider problem by preventing the exclusive use of domestic supplies for the emergency requirements of those buyers who would be willing to pay the necessary insurance premium in the absence of government intervention. Exclusion of free riding is possible, and practical, in many import-competing industries. Exclusion may take the form of vertical integration, long-term-supply contracts, or simply allocation of short supplies on the basis of past shipments.[22] If exclusion of free riders is possible, informed buyers will make socially efficient decisions regarding their dependence on various sources of supply, their choice of contractual arrangement, choice of inventory levels, and so on. Government intervention that prevents the exclusion of free riders at times of a national emergency may be justified by considerations of equity and efficiency, or plain survival. If there is a potential free-rider situation, precautionary government intervention may be required to secure sufficient domestic supplies for emergency situations. Anticipated shortages in the boom phase of a cyclical industry, however, do not normally create a free-rider problem as governments do not interfere with private precautionary arrangements when the boom arrives.

C. Waste Caused by Domestic Price Distortions: Over-priced Inputs

Distortions are more likely to occur on the supply side than on the demand side. A distortion on the supply side exists when the price of the domestic product differs from its marginal social cost of production. The price of the domestic product might, for example, exceed its marginal social cost because the wages paid for labour in the import-competing industry exceed the value of goods and services that workers would produce elsewhere if they were laid off. The wages of workers that may be laid off are part of the domestic producers' marginal *private* cost. Profit-maximizing producers in a competitive market choose that rate of output at which their marginal *private* cost equals the market price. If the marginal private cost exceeds the marginal social cost, producers will choose rates of output at which the market price exceeds the marginal social cost of domestic production. A divergence between the private and the social marginal cost of labour thus has the effect of distorting the price of the import-competing domestic product. In other words, the price of the domestic product in such circumstances overstates the marginal social cost of domestic production. It is implied that in the absence of corrective

intervention, the rate of domestic production falls short of the socially optimal rate and the rate of importation exceeds the socially optimal rate.

The basic result should be established with the aid of another variant of our diagram before the nature of this type of domestic price distortion is explored further in the context of "abnormally cheap" imports. Let us assume the *TT*' curve in Figure 3 represents the marginal *social* cost of domestic production, whereas the marginal *private* cost is still represented by the supply curve *SS*'. As has been explained in the previous paragraph, such divergence between social and private cost of domestic production may exist because the wages that domestic producers have to pay exceed the marginal social opportunity cost of labour.[23] Let us also assume that imports are available at price OP_2, which implies that domestic producers decide to supply quantity *OC*. If *TT*' represents the marginal social cost of domestic production, output rate *OC* falls short of the socially optimal rate of domestic production for the following reason: at output rate *OC*, the marginal social cost of domestic production is indicated by the height of the *TT*' curve, *CN*; the marginal social cost of imports equals OP_2 (or *CK*); at output rate *OC*, the marginal social cost of imports thus exceeds the marginal social cost of domestic production by *NK*;

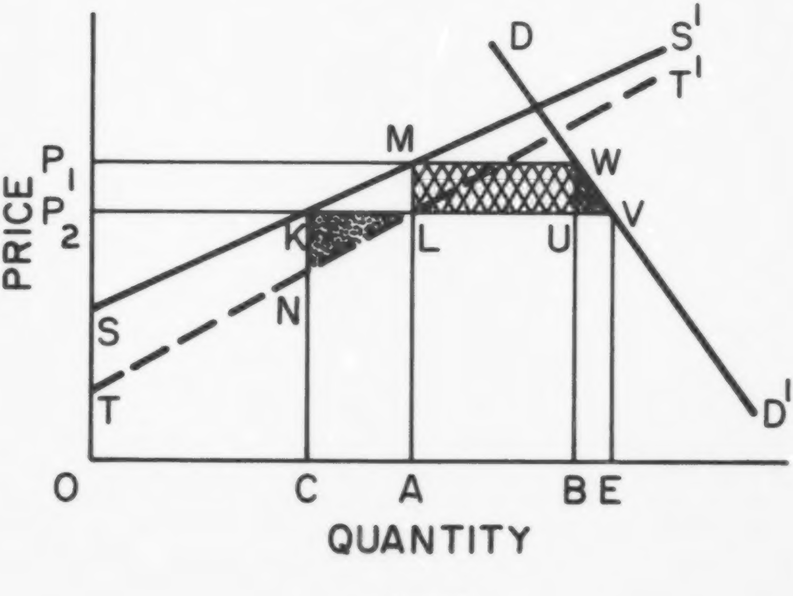


Figure 3

distance NK represents the value of national resources that could be saved by producing one more unit domestically rather than importing it; thus output rate OC falls short of the optimal rate of domestic production. By the same token, of course, the actual rate of importation exceeds the socially optimal rate.

With the price of imports being OP_2 and the marginal social cost of domestic production being represented by TT', the socially optimal rate of domestic production is OA, and the corresponding optimal rate of importation is AE. This is so because for output rate OA, the marginal social cost of domestic production (the height of the TT' curve, AL) equals the marginal social cost of importation (OP_2).[24] Any rate of output larger than OA results in a waste of resources because output beyond OA is more costly than imports would be. Any rate of output below OA also results in waste because resources could be saved by expanding domestic production at the expense of importation.

Indeed, in the presence of the domestic price distortion, the area of the shaded triangle NLK in Figure 3 represents the total value of national resources that could be saved if production were expanded from OC to OA. Without government intervention, however, domestic producers do not find it profitable to supply more than OC. Domestic producers will produce at the optimal rate, OA, only if *either* the price is raised from OP_2 to OP_1 *or* the private marginal cost is lowered from SS' to TT'. Thus there is a choice of policy interventions. The domestic distortions literature has demonstrated that raising the price of imports is an inefficient form of intervention as it results in a "by-product distortion" that can be avoided with interventions that reduce the private cost of domestic producers.[25] The by-product distortion is represented by the other shaded triangle in Figure 3 — triangle UVW. That triangle is familiar as one of the two triangles of waste encountered previously in Figure 1. As will be recalled, the area of triangle UVW represents the loss of consumers' surplus that occurs when an import restriction raises the domestic price of imports above the marginal social cost of importation.[26] In other words, while a tariff that raises the domestic price of imports from OP_2 to OP_1 would induce domestic producers to choose the socially optimal rate of production (OA), the same tariff would cause the rate of consumption (and the rate of importation) to fall short of the social optimum.

Increasing the rate of domestic production to the socially optimal rate by means of an import tariff would be wasteful in itself whenever the area of triangle UVW exceeds the area of triangle NLK in Figure 3. But even when the social gain from the intervention exceeds its social cost, raising the price of imports is inefficient if other forms of intervention can correct the distortion while avoiding the by-product distortion. The fundamental message of the domestic distortions literature has been that by-product distortions generally can be best avoided by intervening as closely as possible to the origin of the domestic price distortion. For the present example, the divergence between private and social cost has been assumed to exist because of wages exceeding the marginal social opportunity cost of labour. If, for reasons to be discussed, the government is unable or unwilling to remove the wage distortion at the source, the "next best" form of intervention is a subsidy for the use of the "over-priced" input. The correct rate of subsidization would lower the private cost from SS' to TT' in Figure 3. Producers would then find it profitable to produce at the socially optimal output rate (*OA*). This implies that imports equal to distance *CA* would be replaced by domestic production. As the intervention would not raise the price of imports, domestic consumption would remain at the socially optimal rate (*OE*). The subsidy would thus avoid the by-product distortion of an import restriction (triangle *UVW*).

The domestic distortions literature generally assumes that subsidies can be financed with "non-distorting taxes"; this means it is assumed that taxation needed to finance the non-distorting subsidies does not cause by-product distortions elsewhere in the economy.[27] Furthermore, it is generally assumed that the cost of collecting taxes and the cost of disbursing subsidies can be ignored. We will return to this point in section 3 when discussing constraints that might prevent policy makers from choosing those forms of intervention recommended by the domestic distortions literature. Finally, it should be reiterated that effects on the distribution of income are largely being ignored in the present context because we are focusing on the efficiency of resource allocation in the presence of domestic price distortions. Alternative forms of intervention may have vastly different effects on the income positions of various domestic groups.[28] We shall see later that differential effects on the domestic income distribution may explain why policy makers in practice prefer forms of intervention that are not optimal from an efficiency point of view. Differential effects on the distribution of income do not, however, affect the ranking of tariffs and domestic subsidies under efficiency considerations. As has been shown in subsection (A) above, direct domestic subsidies are a more efficient means of restoring a desired distribution of income than import restrictions. The same principle applies here: if an intervention that corrects a domestic price distortion efficiently has undesired consequences for the domestic distribution of income, the recommendation is to use additional subsidies and/or taxes that restore the desired income distribution, rather than employ an intervention such as a tariff that reduces national welfare by causing by-product distortions.

In order to establish the concept of a domestic price distortion that might justify government intervention on efficiency grounds, we have so far simply assumed that wage rates exceed the marginal social opportunity cost of labour for some unspecified reason. Let us now return to the narrower topic of this essay. If one wishes to argue that the existence of domestic price distortions might justify government intervention at times of rapidly increasing import penetration, one has to explain why certain domestic distortions are more likely to occur (or are more painful) at times of rapidly increasing import penetration than at other times. Furthermore, one has to consider whether the forms of contingency intervention that governments typically employ are efficient ways of preventing the waste of national resources that domestic price distortions might cause in the absence of government intervention.

The example of wage rates exceeding the marginal social opportunity cost of labour is most pertinent in the context of contingency protection, and labour-related distortions have been used widely to justify short-run intervention. The so-called "market disruption" argument for protection is based, at least partially, on the idea that a country does not benefit from cheaper imports if a rapid increase in importation leads to massive labour lay-offs, especially if such lay-offs are concentrated in regions or occupations with poor alternative employment opportunities. Lay-offs that are caused by import competition do not, of course, necessarily indicate a waste of national resources. If the wage rates that import-competing employers have to pay do *not* exceed the marginal social opportunity cost of labour, shrinking employment in an import-competing industry simply indicates that labour is more productive elsewhere in the economy. Lay-offs do, however, involve an element of waste if wage rates are distorted. Distortions exist because labour unions, minimum wage laws, and equivalent agreements and conventions make wage rates rigid in a downward direction.[29]

The distortions tend to be larger in the short run than in the long run. Wage contracts are rarely adjusted to market conditions in the short run. The opportunity cost of labour is lower in the short run because it takes time for other industries and regions to absorb laid-off workers, and it takes time for workers to adapt to new jobs. In the case of cyclical or sporadic import competition, workers who expect to return to their previous jobs are reasonably reluctant to accept alternative employment. Indeed, considering the investment in job-specific human capital, non-vested pensions, seniority rights, and the cost of relocating homes and families, it generally is wasteful for workers to change jobs when they are laid off temporarily. Given generous unemployment benefits, there may be little incentive for workers to accept temporary work even if it is available. The social opportunity cost of maintaining employment in import-competing production in the short term might thus amount to only a fraction of the cost of labour to employers. The prices of raw materials and intermediate inputs that are used by an import-competing industry also tend to be distorted in the short run because producers of these inputs charge prices that exceed their short-run marginal cost and because their own input prices exceed the marginal social opportunity cost of those inputs.

It is important to note that market adjustment tends to work asymmetrically in the sense that distortions arise mainly from a rapid reduction of employment rather than from an expansion.[30] The reason for the asymmetry is, of course, that in the case of a reduction of employment, workers become idle, at least in the short run, whereas in the case of expansion beyond an industry's normal level of activity, labour generally has to be attracted from other jobs. In the case of expansion, the marginal social opportunity cost of labour is thus closer to the marginal private cost. In terms of Figure 3, this might mean that the TT^{1} line should be steeper and might join SS^{1} at point M, as OA was assumed to be the import-competing industry's normal rate of production. Alternatively, the divergence between SS^{1} and TT^{1} could be assumed to apply only for output rates smaller than OA, but not for rates beyond OA. This point is important because we are now discussing reasons why government intervention might be required when the price of imports falls from the "normal" level (OP_1) to an "abnormally low" level (OP_2). If the divergence between SS^{1} and TT^{1} applied for changes in either direction, an intervention would be required at all times and not only at times of abnormally cheap imports.[31]

Let us now assume that the domestic price distortion arises only for rapid reductions in employment. This means that in Figure 3 the divergence between SS^{1} and TT^{1} applies only when the rate of domestic production is reduced below OA, which is the rate that prevails when the price of imports is at its normal level, OP_1. When the price of imports falls to OP_2, domestic production is reduced to OC. As will be recalled, the presence of the domestic price distortion implies that OC is a suboptimal rate of domestic production. The socially optimal rate of production is OA. Thus the socially optimal rate of production in Figure 3 coincides with the "normal" rate. This is, of course, a special case that results from drawing the TT^{1} curve through point L. In other words, OA is the socially optimal rate of output because the divergence between private and social marginal cost for that rate of output has been assumed to equal the price reduction ($LM = OP_1 - OP_2$). Before turning to other cases, let us consider the effects of contingency protection in the relatively simple situation depicted by Figure 3.

When measures of contingency protection raise the price of imports from the abnormally low level, OP_2, to the normal level, OP_1, domestic producers find it profitable to supply OA rather than OC. As OA is the socially optimal rate of production, one may say that in this case contingency protection successfully compensates the domestic price distortion. Measures of contingency protection, however, are inefficient forms of intervention as they cause avoidable by-product distortions. One of the by-product distortions is represented by the shaded triangle *UVW*. As we saw before, the area of that triangle represents the loss of consumers' surplus resulting from any import restriction that causes domestic consumption to be reduced from *OE* to *OB*. The loss of consumers' surplus is a waste if it can be avoided by employing a domestic intervention that corrects the domestic distortion. Measures of contingency protection cause a further by-product distortion that is represented by the area of the hatched rectangle *LUWM* in Figure 3. That rectangle is familiar from Figure 1, and little needs to be added to what has been said in subsection (A) above. The hatched rectangle represents the value of additional resources that a country has to give up to acquire imports *AB* if measures of contingency protection force or encourage foreign suppliers to sell at the normal price OP_1 rather than at price OP_2. The higher cost of imports is a waste of national resources if other forms of intervention can be used to correct the domestic distortion while avoiding by-product distortions (or causing smaller by-product distortions than contingency protection).

It should be noted that in the case depicted by Figure 3, contingency protection would be wasteful in itself because the by-product distortions would be worse than the original domestic distortion. As will be recalled, the waste resulting from the original domestic distortion is represented by the area of the shaded triangle *NLK*. That area is smaller than the sum of the by-product distortions (area *LVWM*). Thus contingency protection could not be justified on efficiency grounds. If the choice is between contingency protection and no intervention (because other forms of intervention are considered impractical), the country in this case is better off accepting the abnormally cheap imports, although domestic production remains distorted. The relative size of the various areas of waste is, of course, an empirical problem that has to be investigated on a case-by-case basis. One may speculate though that the triangle of wasted consumers' surplus (area *UVW*) is relatively small because the price elasticity of demand tends to be low in the short run. The area of the hatched rectangle is, obviously, larger the larger the volume of imports for which the country insists on paying the normal price rather than the lower price and the greater the price difference.

Contingency protection can be shown to cause yet another by-product distortion if we remove the simplifying assumption that the socially optimal rate of domestic production coincides with the normal rate. This has been done in Figure 4, which contains the same curves

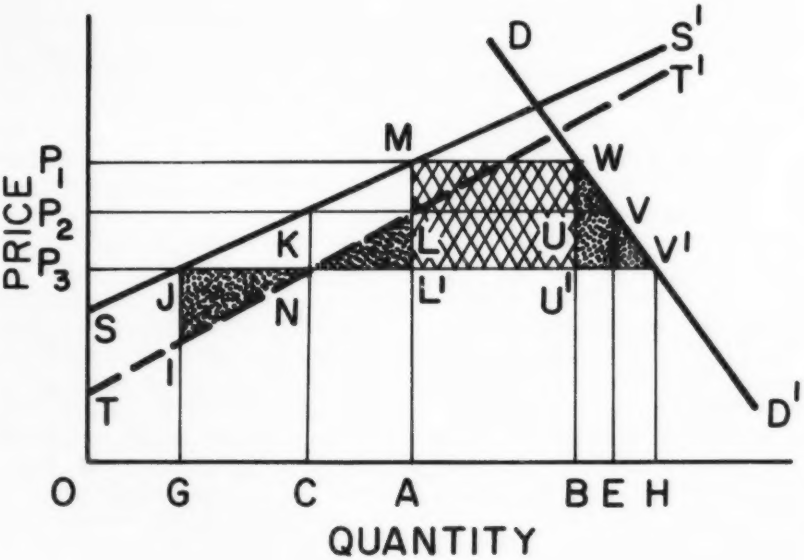


Figure 4

and assumptions as Figure 3, with the exception that in Figure 4 there is a third price, OP_3. If OP_3 is assumed to represent the abnormally low price, the normal output rate (OA) no longer is the socially optimal rate. To demonstrate this point, we simply follow the same procedure as before. When the price falls from OP_1 to OP_3, domestic production is reduced from OA to OG. The new rate of output is suboptimal because of the divergence between TT' and SS'; at output rate OG, the marginal social cost of importation (OP_3) exceeds the marginal social cost of domestic production (the height of the TT' line, GI). The socially optimal output rate in this case is represented by OC, because for OC the marginal social cost of domestic production (CN) equals the marginal social cost of importing (OP_3). The normal output rate (OA) thus turns out to be larger than the optimal rate, as for OA the marginal social cost of domestic production (AL) exceeds the marginal social cost of importing (OP_3).[32]

Now let us look at the various shaded areas in Figure 4. Triangle *INJ* represents the waste of resources that is caused by the domestic distortion if producers are left to adjust to OP_3 without intervention. This triangle, in other words, corresponds to triangle *NLK* in Figure 3, except that triangle *INJ* in Figure 4 occurs for lower output rates because the import price is lower. Optimal intervention should correct the domestic distortion without creating by-product distortions. As before, the standard recommendation is that the use of "over-priced" inputs should be subsidized in order to reduce the marginal private cost to the level of the marginal social cost. Such an intervention would make it profitable for domestic producers to produce at the socially optimal rate, OC. The additional domestic output (GC) would replace more costly imports; the total gain, of course, is represented by the area of triangle INJ if the intervention causes no by-product distortions.[33]

We have seen that contingency protection inevitably causes by-product distortions. Assuming that measures of contingency protection were employed to keep the price of imports at the normal level, OP_1, there are three areas in Figure 4 representing by-product distortions. The shaded triangle $U'V'W$ represents, of course, the loss of consumers' surplus that is caused by any measure that raises the domestic price from OP_3 to OP_1. The triangle is larger than in previous diagrams because the price difference is larger. Another familiar by-product distortion of contingency protection is represented by the area of the hatched rectangle $L'U'WM$. Again, the area is larger because the price difference is larger. The third kind of by-product distortion is represented by the shaded triangle $NL'L$. This kind did not appear in Figure 3 because we had assumed that the optimal rate of production coincided with the normal rate. The area of triangle $NL'L$, of course, represents the waste of resources caused by producing at a rate that exceeds the socially optimal rate of domestic production (OC). If quantity CA were imported, its social cost would be equal to the area of rectangle $CAL'N$. When the same quantity is produced domestically, the social cost is represented by the area under the TT' curve, $CALN$. Triangle $NL'L$ thus represents a waste of resources that occurs because contingency protection induces domestic producers to supply at the normal rate (OA), rather than at the socially optimal rate (OC).

Since Figure 4 has been derived from Figure 3, it comes as no surprise that in the case depicted by Figure 4, contingency protection makes a country far worse off than it would be in the absence of government intervention. The sum of the three by-product distortions is much larger than the waste of resources that is caused by the original domestic distortion. Furthermore, the deficit of potential policy benefits is much higher in Figure 4 than in the previous diagram because the abnormal price was assumed to be lower. While the relative size of policy benefits and costs is an empirical question, one should note a point of general importance: measures of contingency protection cannot necessarily be justified as "second best" forms of intervention when "first best" interventions, such as domestic subsidies, are considered to be impractical. We shall see in section 3 that various types of constraints prevent the use of policy measures that cause less serious by-product distortions than contingency protection. In such circumstances, it is tempting for policy makers to conclude that they might as well use measures of contingency protection, on the grounds that such measures are "better than doing nothing." While the administrative and political costs may be lower in the case of contingency protection than in the case of domestic subsidies, policy makers and the public tend to overlook the hidden costs of by-product distortions and fail to recognize that, from an efficiency point of view, contingency protection can clearly be worse for a country's welfare than doing nothing about a domestic distortion.

It is also worth repeating that the by-product distortions of contingency protection are larger in the case of Figure 4 than in the case of Figure 3 because the difference between the normal and the abnormal price is larger in Figure 4. Policy makers and the public tend to regard the implementation of contingency measures as more urgent the larger the margin of foreign price cutting. A larger reduction in the import price presumably has more drastic consequences for the income positions of domestic producers. The relationship between the extent of foreign price cutting and the magnitude of the waste resulting from domestic price distortions (over-priced inputs) is less certain. In any event, the larger the reduction in the price of imports, the more urgent it is to look for alternative forms of intervention that avoid (or diminish) the by-product distortions that are associated with measures of contingency protection.

D. Waste Caused by Domestic Price Distortions: Monopolistic Conduct of Domestic Producers

Up to this point, we have assumed perfect competition to prevail in the output market, which means that domestic manufacturers are price takers who expand output to the point where the marginal (private) cost of production equals the given market price. This assumption is, of course, implied by the use of graphs for perfectly competitive domestic commodity markets. Given the assumption that domestic producers are price takers, a divergence between price and marginal social cost of domestic production could arise only because the marginal private cost differed from the marginal social cost. Accordingly, we assumed in the previous subsection that inputs were over-priced. If we remove the assumption of perfect competition in the output market, divergences may arise between the producers' marginal cost and the prices they charge for their products. In other words, import-competing goods may be over-priced because domestic producers possess some degree of market power.

I believe that this type of distortion is rather important in the context of short-run adjustment to abnormally cheap imports. Even if, in the long run, the prices of oligopolistic domestic producers in the domestic market do not exceed the level of their average "full" cost, those prices tend to exceed the short-run marginal social cost at times of idle capacity. Maintaining prices above short-run marginal cost is rational from the point of view of private producers when imports are imperfect substitutes for domestic products. As I have shown elsewhere, wasteful imports may occur as a consequence of this type of domestic price distortion.[34] In essence, wasteful imports occur because the unwillingness of import-competing domestic producers to cut prices at times of idle capacity induces domestic buyers to import goods that the country could acquire at a lower social opportunity cost if domestic production were expanded (or if capacity utilization were maintained at a higher rate).

It would take too many pages to introduce the more complicated graphs that are required for the case of imperfect competition and too many pages to discuss the policy implications in detail. It should be noted, however, that the approach that I have used in the earlier papers can overcome some of the analytical limitations of the simpler perfect-competition case. In addition to demonstrating the consequences for national welfare of domestic market power in an open economy, the imperfect-competition approach permits the existence of different prices for domestic goods and imported substitutes; permits imports at normal and abnormal prices to occur simultaneously; permits imports and exports of the "same" good to occur simultaneously; permits the assumption of private objectives other than profit maximization; and permits the analysis of a combination of several distortions. The imperfect-competition approach also extends the range of types of intervention that might be used to correct domestic price distortions. If monopolistic conduct of domestic producers is causing wasteful imports, measures that promote competition or that control domestic prices directly might be employed to remove or reduce the domestic distortions. The imperfect-competition approach does not, however, change our basic conclusion that the existing measures of contingency protection are wasteful forms of intervention.

E. Export Promotion as a Means of Reducing Domestic Distortions

To round out this discussion of efficient policy intervention in the presence of domestic distortions, let us look briefly at the case of an exporting industry. Figure 5 still is a variant of the earlier graphs. We again assume a perfectly competitive domestic industry for which the world market price is a datum. The curves in Figure 5 are all as before, except for the NN' line, which will be introduced later. Assuming the world market price equals OP_1, the graph depicts the case of an exporting industry, because at that price domestic producers are

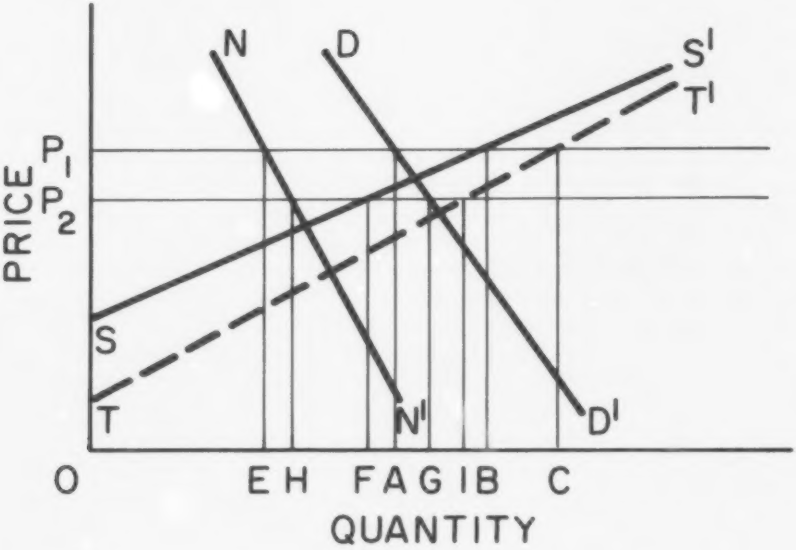


Figure 5

supplying a larger quantity of the good than domestic buyers are willing to absorb. More specifically, the industry exports quantity *AB*.

A potential reason for government intervention arises if we introduce a domestic price distortion. Say, inputs used by this particular industry are "over-priced" in the sense discussed in subsection (C) above. As was the case in previous graphs, the existence of over-priced inputs in Figure 5 is represented as a divergence between the domestic producers' marginal private cost (SS') and the marginal social cost (TT'). Assuming that the divergence applies for all rates of output, the socially optimal rate of production in Figure 5 is *OC* because for that rate of output the marginal social cost of the good (the height of the TT' line) equals its marginal social value (OP_1). Domestic producers who have to hire or purchase over-priced inputs will produce only quantity *OB*. Subsidization of the use of over-priced inputs can induce producers to expand output to the optimal rate, *OC*.

The argument for socially optimal intervention in the case of over-priced inputs thus applies to an exporting industry in basically the same way as for an import-competing industry. Two specific points should be noted, however. First, Figure 5 shows that the additional output that is induced by the intervention (quantity *BC*) goes into exports entirely; there is no change in domestic consumption as the intervention does not change the price of the good. This result occurs even though the subsidy does not take the form of an export subsidy.[35]

Secondly, the increase in exports cannot be said to injure producers in any other country because we have assumed that the world market price is given for the exporting country. The country's share in the world market is small enough for it to increase its exports without lowering the price.

Let us now assume the industry was hit by a downturn in the market. Such a downturn could manifest itself by a fall in domestic demand, a fall in the world market price, or both. Let us assume initially that only domestic demand had fallen, say from DD' to NN' in Figure 5. With the new demand curve, the rate of domestic consumption decreases from OA to OE. As the world market price remains at OP_1, there is no change in domestic output. That means exports increase by the full amount by which domestic demand has decreased. The shift in domestic demand does not create a reason for government intervention or a change in existing government measures. In particular, the drop in domestic demand does not affect employment or the income of factors of production as total output remains unchanged. And again, the increase in exports cannot injure foreign producers as the world market price is given by assumption.[36]

A reduction in the world market price could, of course, be caused by a world-wide reduction in demand, or by a major improvement of supply conditions in other countries, or by the introduction of subsidies in several countries that jointly constitute a significant share of the world market. Let us now assume the price had fallen from OP_1 to OP_2 in Figure 5. If DD' remained the domestic demand curve, the exporting industry would turn into an import-competing industry, because at the lower price domestic producers would supply only quantity OF, whereas consumers would wish to buy OG. If, in addition to the fall in price, domestic demand shifted from DD' to NN', the industry would continue exporting (at rate HF if there was no intervention). In both cases the rate of production would be the same (OF), since it is determined by the world market price.

In neither case is there a reason for government intervention unless there is a domestic distortion. Such a distortion could arise, however, as a consequence of the decrease in the rate of domestic production from OB to OF that occurs when the world market price falls from OP_1 to OP_2. More specifically, inputs that the industry lays off might be over-priced in the short run, as was assumed in subsection (C) above. In that case, the divergence between SS' and TT' would apply only for rates of output smaller than the "normal" rate, OB, and the distortion would apply only in the short run. The policy implications would, of course, remain basically the same as discussed before: the use of over-priced inputs should be subsidized to maintain production at the socially optimal rate (OI) rather than the rate that private producers find most advantageous if they respond to market forces (OF).

As always, the policy conclusion must be qualified by saying that we assume the distortion of domestic input prices to be "given"; for example, we accept the market power of labour unions or the existence of minimum wage laws causing the distortion; we assume the reduction in the world market price to be temporary (if it were not, adjustment aid that moves over-priced inputs to other uses might make more sense than subsidizing their present use); we also assume that the cost of implementing the policy measures does not exceed their social benefit, and so on. Such qualifications should not, however, distract from the principal point of this subsection, which is that the domestic distortions approach suggests the same type of corrective measures for an exporting industry as was developed above in more detail for the case of import-competing industries. In other words, domestic policy measures that increase an industry's rate of exportation can be shown to increase national welfare if domestic prices are distorted.

This subsection has shown also that all of the additional output resulting from the domestic intervention is exported if we make the conventional assumption that the exporting industry exerts no influence on the world market price.[37] In effect, the domestic intervention thus removes the domestic distortion by stimulating exports, although the government does not use measures that might be labelled "export promotion." By the same token, the assumption that an individual country cannot change the world market price implies that competitors in other countries cannot suffer injury from an individual country's increase in exports. This is not to say, of course, that injury cannot happen in any circumstances. The conventional assumption of a given world market price may not be appropriate for many real-world cases. The actions of some countries can influence the world market price because their domestic industries constitute a substantial share of global supply; the actions even of small individual countries may affect prices in certain submarkets that are relatively closed or relatively open to foreign trade.

Optimal export policies under conditions of imperfect competition have been discussed elsewhere.[38] Models that remove the assumption of a given world market price can show why, in the presence of domestic distortions, it may be in the interest of a country to employ policies that reduce prices in export markets. In such circumstances, the policies of an individual country could thus cause injury to competing producers in other countries. For many countries and industries, however, the assumption of a given world market price would appear to be a fairly good approximation. In such cases, the "causation" between foreign policies and injury to domestic producers could at best be indirect. Thus, import-competing producers might experience a dramatic price reduction that is (partly) caused by the collective impact of subsidization of production in several countries, rather than the deliberate attempt of any single country at cutting export prices.

Lest a wrong impression be created, it should be recalled that under the domestic distortions approach the cause of an "abnormally low" import price is largely irrelevant. As has been shown in subsections (A) to (D) above, the fundamental question is whether distortions exist in the domestic market and how they can be corrected most efficiently. Why is it then that the matter of causation is typically such a central issue when measures of contingency protection are being applied? This puzzle brings us back to a broader question: why is it that countries insist on using measures of contingency protection that restrict imports rather than measures that the domestic distortions approach has shown to be more efficient?

3. Domestic Constraints Preventing Policy Makers From Choosing Efficient Forms of Intervention

A. What Has to Be Explained

In the preceding section of this paper, I have employed tools of economic theory, which are widely accepted by economists, to analyse the policy problems that might arise when imports become "abnormally cheap." The principal conclusions can be summarized as follows:

- Abnormal cheapness of imports poses a policy problem only inasmuch as a distortion arises in the domestic market of the importing country.
- There are several types of potential domestic distortions that must be distinguished in the context of abnormally cheap imports, as different types of distortions require different policy responses.
- Alternate forms of intervention that might be used to correct a particular domestic distortion cause hidden social costs (by-product distortions) of varying nature and magnitude.
- The typical measures of contingency protection are most costly in terms of the importing country's welfare because they force or encourage foreign suppliers to raise their export prices (or to maintain their export prices at a higher level than they otherwise would).
- In certain circumstances it is less costly to leave a distortion uncorrected rather than employ policy tools causing severe by-product distortions.

On the basis of our theoretical considerations, one would expect policy makers who are concerned with the augmentation of national welfare at times of abnormally cheap imports to devise contingency policies with the following characteristics:

- The nature and extent of distortions in the domestic market (rather than in the countries of origin) would be at the centre of any investigation of a need for government intervention in cases of abnormally cheap imports.
- The cause of an abnormal cheapness of imports would matter only to the extent that it helps to predict the expected duration and frequency of the abnormal cheapness (as the duration and frequency may be important for the choice of remedies to correct domestic distortions).
- An attempt would be made to avoid or reduce by-product distortions by applying specific domestic remedies as closely as possible to the root of any domestic distortion.
- The use of contingency measures that force or encourage foreign producers to raise their export prices would be avoided wherever less costly forms of intervention are feasible.
- The implementation of contingency measures would be suspended in cases where it is evident that the social costs of the intervention exceed its social benefits.

What we observe in reality is quite different from what the domestic distortions approach leads us to expect:

- While there usually are comprehensive investigations into the extent of injury that domestic producers suffer because of abnormally cheap imports, the criteria employed are not well suited to distinguish between different types of domestic distortions (different motives for intervention) that would require different least-cost remedies.
- The determination of price distortions abroad (so-called "unfair" pricing on the part of foreign suppliers) is crucial for the implementation of anti-dumping and countervailing duty measures (Article VI of the GATT); indeed, the determination of domestic injury officially does not even begin until the unfairness of foreign prices has been established; even in the case of escape clause actions (Article XIX of the GATT), the implementation of protective measures is usually accompanied by an innuendo of "unfair" or "anti-social" foreign prices or wages, although escape clause actions may legally be taken in the absence of unfair pricing.
- As the exact nature of domestic distortions that might require intervention is rarely discovered, the authorities concerned rarely consider domestic remedies which would get at the root of domestic

problems that appear when imports become abnormally cheap; hidden social costs (by-product distortions) of intervention are usually ignored.

- Measures of contingency protection (anti-dumping duties, countervailing duties, or voluntary export restraint agreements) that force or encourage foreign suppliers to raise their export prices to the "normal" or "fair" level are the favoured forms of intervention that the United States, Canada, and the European Community employ to counteract or prevent an abnormal cheapness of imports.
- Just the same forms of contingency protection have been endorsed by the GATT and related codes and agreements; thus there appears to be an international consensus that the types of intervention which are most costly in terms of the importing countries' welfare ought to be tolerated, whereas less costly domestic interventions are often ostracized for being forms of "new protectionism" that are inconsistent with the agreed order of international trade.

The rest of the paper is an attempt to explain the noted discrepancies between the policy behaviour predicted by economic theory and the pattern of contingency policies that we observe in the real world. The presentation can be relatively brief as many of the relevant points are covered in other papers in this volume.[39]

B. Strategic Behaviour of Domestic Producers

While the domestic distortions approach has not to my knowledge previously been employed to analyse in detail the specific policy problems that might arise when imports become abnormally cheap, the principal conclusions of this approach are, of course, well known among specialists. Furthermore, many economists have tried before to explain why it is that governments around the world continue to intervene by restricting imports when economic theory can demonstrate that it would be less costly from a social point of view to tackle domestic distortions with domestic types of intervention. Max Corden, for example, acknowledges that "the whole 'subsidy-biased' approach seems to have a great air of unreality about it."[40] He points out that the domestic distortions approach tends to disregard certain costs of financing and distributing subsidies as well as political forces that favour hidden subsidization by means of import restrictions over open subsidization.

As Corden sees it, public choice is often governed by an element of illusion:

> Explicit taxation imposes psychic costs which implicit taxation does not. These are costs in the minds of the taxed public and hence costs to the government in loss of popularity. . . . It may be understood

> that on the imports that remain, tariffs are equivalent to sales taxes, but it is often not understood that the *subsidy-equivalent* of the tariff is like a subsidy to producers financed by a sales tax. So a fiscally hard-pressed government's reluctance to replace protective tariffs with subsidies is understandable.[41]

The cosmetic attraction of tariffs over taxes cum subsidies on the financing side is paralleled by cosmetic advantages for those who receive tariff or quota protection rather than open subsidies:

> A subsidy financed by tax revenue and hence going through the budget makes it obvious that an industry is protected. A clear sum of money stands witness to the cost, even though it is not, strictly, a measure of welfare cost. By contrast, a tariff or quota hides the reality. . . .
>
> Protection unnoticed is protection more secure. And, even when it is noticed, tariff legislation is not normally annually renewable, while by contrast, in democracies budgets are annual and their contents are often scrutinized with embarrassing thoroughness.[42]

The last part of the quotation suggests that the beneficiaries of redistributive measures may have reason to believe society would be less generous if the true cost of such measures were a matter of public knowledge. In other words, import restrictions are preferred tools of redistribution because they permit fooling the public about the extent of the redistribution (not to mention the extent of the hidden social costs of the intervention). This general argument applies with special force to the case of contingency protection, as the mechanisms of contingency protection have a low profile and their purpose and effects are well camouflaged.

When I introduced the type of "pure distortion of domestic income distribution" in subsection 2(A) above, I simply assumed, for the sake of argument, that society was willing to restore the normal income positions of domestic producers who had been injured by abnormally cheap imports. Why should society be willing to do this? We do, of course, observe in other areas of public policy that society accepts responsibility for alleviating the distress of individuals and firms who suffer an abrupt loss of income or wealth. Unemployment "insurance" and various forms of disaster aid come to mind. Indeed, Bruce Owen and Ronald Braeutigam have argued persuasively that the increasing scope of government regulation of private industry must be seen as evidence of voters agreeing "that the victims of economic change should not be placed at the mercy of the impersonal market, but should instead be protected by a mechanism that provides economic justice."[43] Administrative procedures of allocation are preferred to the market mechanism because people are risk averse. In sum, "the intention [of regulation] is to attenuate the rate at which income is redistributed in society as a result of market forces and technological progress."[44] Furthermore, the economists' recommendations concerning efficient forms of intervention "may be inaccurate if people view money transfers as inherently inferior ('distasteful') to economically equivalent compensation in the form of delay, outright blockage, or alternative concessions."[45] All of these considerations might also apply to the regulation of import competition. It seems strange, however, that the rationale of contingency protection rarely is stated in such terms. To make a special case for protection against "injury" caused by aggressive foreign competition, it appears necessary to obscure the nature of the problem. In the following it will be shown that the need to camouflage the purpose of contingency measures, as well as their cost, implies the use of procedures and remedies that practically rule out using the domestic distortions approach.

There are five principal elements that interact to form the smoke screen that hides the purpose and effects of anti-dumping and countervailing duty policies:

1. Misrepresentation of policy objectives
2. Use of value-charged terminology
3. Focusing on the conduct of foreigners
4. Deliberate disregard for policy alternatives
5. Pseudo-scientific investigation procedures.

Before these elements are discussed in detail, it should be made clear that my usage of the terms "camouflage" and "smoke screen" does not necessarily imply the existence of a comprehensive design or even a conspiracy to deceive the public. While a few sophisticated insiders may be exploiting ingrained ways of thinking and public emotions, it appears that most participants more or less innocently believe in the procedures and arguments that I am calling elements of a smoke screen. Indeed, the credibility of the existing system largely depends on the congruity between accepted ways of thinking and the mechanisms of contingency protection.

As regards item (1), the misrepresentation of policy objectives, there can be little doubt that, in the final analysis, restoring the income positions of domestic producers is the only policy objective that counts when the Anti-Dumping Tribunal determines whether or not dumped imports have caused or are likely to cause "material injury to the production in Canada of like goods" as required by the Anti-Dumping Act.[46] There probably is some political support in most countries for redistribution policies that prevent or moderate the massive short-run shifts in income that might occur as a consequence of abnormally cheap imports. In other words, for equity considerations, a dollar of traditional income that import-competing producers would lose might be given a greater weight in society's welfare function than a dollar of windfall gain that buyers would derive from abnormally cheap imports. Equity considerations appear to be an especially strong factor in the political support for countervailing duty provisions that are thought to rest on the notion that domestic producers should not have to compete in the home market with the treasury of another country.[47] Yet it is rare for policy makers or complaining domestic producers to admit that preserving the traditional income distribution is the principal (if not the exclusive) objective of anti-dumping and countervailing measures. It seems safer to fudge the issue.

To begin, the wording "material injury to the production in Canada" in section 16 of the Anti-Dumping Act appears to imply that more is at stake than simply a matter of domestic income distribution.[48] Furthermore, the Anti-Dumping Tribunal in its Rules of Procedure invites participants in hearings before the Tribunal to submit (among other things) evidence concerning "the reduced employment of persons, and the reduced utilization of capacity by producers in Canada of like goods. . . ."[49] This again seems to suggest that the Tribunal is charged with more than simply investigating whether or not foreign dumping has reduced or is threatening to reduce the income of domestic producers. The appearance is, however, deceptive. While the Tribunal presumably tends to regard injury as more material if income losses of unemployed workers occur in addition to income losses of under-utilized firms, it has consistently refused to be concerned with the efficiency of resource allocation. In particular, the Tribunal does not investigate as to whether domestic price distortions might cause wasteful imports or whether dumped imports can, indeed, be acquired at a lower social cost than like domestic goods.[50] Even if one concedes a presumption that domestic prices generally exceed the short-run marginal social cost of production at times of under-utilized capacity, there still remains the problem of efficient remedies. Under the existing system, the authorities that implement anti-dumping and countervailing measures have no mandate to investigate the relative costliness of alternate remedies. There is just one remedy, forcing foreign competitors not to charge abnormally low prices, and nobody seems to care whether the cure might be worse than the disease.

Another misconception concerning the purpose of anti-dumping policy stems from the widespread fear of "predatory" pricing. As noted in subsection 2(B) above, it is common for even relatively sophisticated observers to believe that the prevention of predatory pricing is a primary objective of anti-dumping policy. Yet nothing in Canadian anti-dumping law and procedure suggests that the policy is especially designed to deal with predatory dumping; and not one of the almost one hundred cases that have been decided by the Anti-Dumping

Tribunal concerns a product for which a foreign supplier could have hoped to come even close to establishing a monopoly position.[51] It appears that the allegedly anti-predatory thrust of anti-dumping measures is a very successful case of camouflage, almost a case of self-deception on the part of the public.

Finally, euphemistic language in official documents tends to contribute to the misrepresentation of policy objectives by suggesting that national interests are at stake when, in fact, the policy is designed to further the interests of particular groups. The introduction to the recent Canadian government proposals for post–Tokyo Round changes in import legislation, for example, contains the following statement:

> If Canada is to equip itself to take full advantage of its rights under the GATT, particularly as set out in the new agreements, certain amendments to existing legislation will be required.[52]

How could uninitiated readers of such language escape the conclusion that the proposed amendments, which would "strengthen" Canadian import legislation, have been designed to protect the national interest?

It is quite apparent that public misconceptions concerning the objectives of contingency protection are closely related to the use of value-charged terminology. Item (2) on my list of elements of camouflage, therefore, is largely a special case of item (1). The crucial terms are "injury," "normal" or "fair" prices, and "dumping." The general value connotation of these terms carries the moral verdict that someone who is dumping (charging less than "normal" or "fair" prices for export sales) and thereby causing "material injury" to competing producers is doing something wrong. The policy objective thus becomes one of preventing wrongdoing, and a separate justification for the redistributive effects of anti-dumping policy is not required.[53]

International trade law employs the term "injury" not simply to describe a loss of income or wealth. According to a widely used dictionary,

> [the terms] *injury* and *wrong* have special application to injustices for the redress or punishment of which legal action can be taken, both applying to a violation of the private rights of an individual, and *wrong* alone, to crimes and misdemeanors which affect the whole community. . . .[54]

A violation of the private rights of domestic producers is presumed to occur if foreign competitors employ unethical forms of pricing. To many lawyers, and of course the public, terms such as "normal value" or "fair value" are not just technical terms as defined by existing laws. Lawyers often appear confident that their sense of justice tells them how to distinguish between fair (ethical) and unfair (unethical) forms of pricing. It so happens that the lawyers' (and the public's) idea of fair pricing generally coincides with the businessman's code of ethics. To a person steeped in the businessman's code of ethics, it may seem completely natural for import-competing producers to request protection because foreign export prices are lower than foreign home market prices, or lower than full cost, or lower than they would be without government aid, or lower than they would be if foreigners paid "fair" wages, and so forth. The same person might be at a loss, however, as to why businessmen should be protected against so-called "unfair" import prices while they are expected to take many other risks in the market-place. If the concern was about a waste of national resources, it should be recalled that such waste can occur only because of domestic price distortions and the fairness or unfairness of import prices would be largely irrelevant. And in any event, domestic remedies would be less costly for the importing country than forcing foreigners to raise their prices.

The term "dumping" has an even stronger value connotation than unfair pricing, implying offensive behaviour that ought not to be tolerated. A well-known U.S. specialist in international trade law once thought he could undercut this economist's national welfare argument by commenting: "You too would object if someone dumped a load of dirt on your front lawn, wouldn't you?" It appears that many lawyers and members of the public share the view that domestic producers hold some form of property right to their home market and may expect the state to prevent foreign competitors from "unloading" abnormally cheap goods on their property.[55] Taking the broader view proposed by Owen and Braeutigam, one might say that anti-dumping laws are just a special form of regulation that, like other forms of regulation, assigns a property right to the *status quo*.[56]

Professional economists, of course, also tend to be captives of their own particular value system. Dumping implies price discrimination, and price discrimination points toward the existence (and abuse) of monopoly power (albeit in the exporting country). Monopoly is bad; dumping should, therefore, not be tolerated. This simplistic chain of reasoning may be a partial explanation as to why many economists go along with anti-dumping policies. It has taken the economics profession a long time to appreciate that preventing price discrimination in oligopolistic markets may severely reduce the extent of price competition that is compatible with the given market structure.[57] From the viewpoint of an international oligopolistic industry, anti-dumping policies can be regarded as a form of government regulation helping national subgroups to limit the aggressive interpenetration of their domestic markets. It is hard to understand how an economist familiar with the realities of international trade could argue "that antidumping regulations act as an extension of antitrust legislation."[58]

Assuming that the political support for anti-dumping policies depends largely on the public conception of dumping being unethical, it is only consistent for anti-dumping procedures to focus on the conduct of foreign suppliers. Still, focusing on the conduct of foreigners appears as a separate item (3) on my list of elements of camouflage for at least three reasons. First, the existing procedures reinforce the public's impression that foreign suppliers' pricing practices are at fault. Each time it is reported in the press that the deputy minister of national revenue for customs and excise has sent out his officers to investigate foreign pricing practices, a few more members of the public become convinced that dumping must be unethical. Secondly, focusing on foreigners helps import-competing producers to mobilize a response of national solidarity that could not be mobilized if the procedures were focused on domestic distortions. While enlightened politicians and journalists may normally try to restrain the protectionist instincts of the majority, it becomes extremely difficult for anyone to stand up against protectionism when foreign competitors are making substantial inroads into the domestic market by means of aggressive pricing and foreigners' prices are found to be "unfair."

> Men are less tolerant of questionable methods of competition, or even of any methods of competition, to which they or their fellow-citizens are subjected, when the agents are foreigners. What they accept as reasonable when done to them by a fellow-citizen, or even as laudable when done by a fellow-citizen to a foreigner, they bitterly resent when done to one of themselves by a foreigner.[58a]

Finally, focusing on the conduct of foreigners is an element of camouflage also because it diverts attention from domestic price distortions and alternate, more efficient, forms of intervention.

This is the point at which we must consider item (4) of our five principal elements of camouflage. While the beneficiaries of contingency protection find it in their interest to foster the impression that government intervention against abnormally cheap imports serves objectives that go beyond preserving the domestic producers' income positions, the procedures of contingency protection rarely consider alternate objectives or alternate forms of intervention. The conspicuous disregard for efficiency considerations, in my opinion, does not suggest that efficiency grounds for intervention could rarely be found in the context of abnormally cheap imports. Given the short-run rigidity of domestic prices and wages, one might rather presume that socially wasteful imports occur quite frequently when unusually aggressive import penetration results in drastically reduced capacity utilization and massive labour lay-offs for competing domestic industries. I furthermore believe that policy makers are generally aware of domestic distortions that might justify intervention on efficiency grounds, although they prefer to use the less well-defined concept of "market disruption." It appears that the real explanation for the lack of explicit efficiency considerations is the desire to hide domestic policy alternatives that would be much less attractive for domestic producers than measures of contingency protection, and that could also be potentially embarrassing for the government.

As may be recalled from the discussion in subsections 2(C) and (D) above, wasteful imports occur because domestic inputs are being paid more than their marginal social opportunity cost and/or because import-competing domestic suppliers charge prices that exceed the marginal cost of producing equivalent goods in the importing country. Focusing the contingency procedures squarely on efficiency considerations would entail several serious disadvantages for domestic producers. Exposure of the role of domestic price distortions would reduce public support for contingency protection and might create pressure for governments to intervene closer to the origin of the distortions. If it became widely known that abnormally cheap imports "cause" national welfare losses only because domestic goods are "over-priced" as a consequence of the market power of domestic unions and firms, public support for measures that keep import prices at some normal level might be less enthusiastic than it is under the present system.[59] In order to avoid wasteful imports, governments might try to reduce domestic wages and prices (or their rates of increase) directly. If the domestic distortions cannot be removed, governments might decide not to intervene at all, as the by-product distortions of contingency protection might result in a greater welfare loss than the original distortions. In either case, the public would be unlikely to support full compensation of domestic producers for income losses, because the compensation would have to take the form of visible subsidies, and also because the veil of alleged foreign wrongdoing would become considerably more transparent if contingency procedures were focused on domestic distortions.

Furthermore, procedures that expose the role of domestic price distortions would make it more difficult for domestic producers to trigger interventions that protect their income positions by simply refusing to defend their markets against aggressive foreign competition. Under the present system, domestic producers and labour unions have an incentive to let lay-offs and plant closures happen because only when "injury" gets bad enough does the government feel compelled to implement anti-dumping measures, countervailing duties, or escape clause actions, whichever the case may be. If domestic producers quietly reduced prices and wages (or the increase of prices and wages) in order to defend their markets against aggressive import competition, they could have little hope that the government would implement escape clause measures; and anti-dumping or countervailing duty actions could not go very far either if defensive pricing by domestic producers kept the volume of dumped or subsidized imports at a negligible level. For the existing contingency procedures to be activated, unusually aggressive import competition must have caused or must threaten to cause some measure of injury to domestic production. If the required measure of injury includes evidence of sales lost to unusually aggressive foreign competition, the existing procedures encourage import-competing producers not to defend their domestic markets as vigorously as they otherwise might. While such strategic behaviour may initially be more costly than a competitive response, producers and their employees can expect to recover any losses after the government has intervened to restrain unusually aggressive import competition.[60] Thus contingency protection, like commercial insurance, may create a "moral hazard." If contingency policies were guided by the domestic distortions approach, there would be fewer opportunities for producers and unions to trigger measures that restrain unusually aggressive import competition. The government might, indeed, attack domestic price distortions directly or might wait for them to be eroded by the impact of unrestrained import competition.[61] Again, producers and their employees could not expect to be protected against loss of income to nearly the same extent as under the existing procedures.

From the domestic producers' point of view, one of the attractive features of the existing procedures is their deterrent effect, as it protects them against unusually aggressive import competition in a most inconspicuous manner. While the mere existence of anti-dumping or countervailing duty laws and of escape clause provisions may not have a significant deterrent effect, certain industries can be "sensitized" by a relatively small number of successful complaints, the initiation of import monitoring schemes, or bilateral government-to-government discussion. Foreign competitors will restrain themselves if they must anticipate anti-dumping or countervailing actions. Even if they need not anticipate enforcement with certainty, foreign suppliers and domestic importers will be reluctant to test the law and the determination of the enforcement agencies, since the procedures are costly in many respects. The deterrent effect of the existing contingency provisions thus protects domestic producers against unusually aggressive import competition with a minimum of enforcement activity. While the enforcement activity may be sporadic and selective, the protective effects may well last for many years and may cover a much broader area of the market than merely the firms and products that were involved in the actual proceedings. If the existing contingency measures were replaced by domestic remedies, the deterrent effect would disappear. If under the domestic distortions approach domestic producers and their employees expected to be compensated for injury suffered from unusually aggressive foreign competition, they would have to present their claims in each individual case, for each product, firm, and period.

For all these reasons, it is understandable that domestic producers and labour organizations are not exactly promoting the idea that the existing forms of contingency protection be replaced by domestic remedies. Under the existing procedures, it is in the interest of import-competing producers to foster the impression that unusually aggressive import competition causes a waste of national resources because they cannot depend or do not wish to depend entirely on the public's willingness to protect their income positions for the sake of equity and fairness. But it is not in the interest of import-competing groups to lobby for contingency policies that squarely focus on the efficient allocation of the country's resources.

Governments also have little incentive to adopt procedures based on the domestic distortions approach because such procedures would confront policy makers with embarrassing policy choices going well beyond the problem of financing domestic subsidies referred to earlier in this section. Would the government wish to force labour unions to agree to a roll-back in wages at times of sectoral unemployment or would it wish to force import-competing producers to reduce their prices to the level of short-run marginal cost when a significant proportion of capacity is idle? If domestic price distortions are regarded as given, could the government politically justify subsidizing the use of "over-priced" inputs or subsidizing the sale of "over-priced" domestic goods? How could any subsidization programme intended to correct domestic distortions be implemented successfully in a highly volatile market? A direct reduction of cyclical domestic price distortions may be possible in special circumstances, such as state ownership of domestic production or state trading.[62] Under the general conditions of Western industrialized countries, however, it is much safer for governments to rely on the existing, socially wasteful, measures of contingency protection rather than attack domestic distortions direcly.[63]

Finally, the redistributive purposes of the existing contingency policies are camouflaged also by (5) the elaborate pseudo-scientific investigation procedures that are being employed to determine whether all legal criteria for the implementation of protective measures are fulfilled.[64] As critics of government regulation have pointed out, one of the major roles that the regulatory process can play, and that those who are being regulated often want it to play, is the imposition of due process requirements on changes in the existing set of goods, prices, or other market conditions.[65] In consequence, "regulation can provide the enterprise sector with *legal rights* to the status quo."[66] Elaborate procedural requirements help legitimize the protective effects of the anti-dumping system. Redistributive effects that might be regarded as rather arbitrary if anti-dumping actions were seen as political decisions are not being questioned very much, since everything appears to be in order with the procedures. The style of hearings before the Anti-Dumping Tribunal might even suggest that a balancing of the interests of opposing parties is built into the process. If, however, dumping is found to have caused material injury to domestic producers, the interest of domestic consumers has no weight at all. As Michael Trebilcock and John Quinn have put it:

> Creating an appearance that the process of decision-making is technically rigorous, scientifically rather than normatively based, and apolitical in nature, lends a necessary "air of verisimilitude to an otherwise bald and unconvincing narrative."[67]

The "air of verisimilitude" presumably is enhanced by the fact that most countries can claim that their contingency policies are fully consistent with the GATT and related codes of international trade conduct.[68]

C. Contingency Protection as a Prerequisite for Trade Liberalization

It must be recognized that the existing contingency measures are the result of a compromise between political forces supporting the use of stronger regular trade restrictions and political forces favouring general trade liberalization. Historically, the alternative to contingency protection was the use of more regular protection rather than the use of domestic remedies that would have corrected domestic distortions. On this I agree with Rodney Grey who has observed that

> . . . both Canada and the U.S. early on saw that there were forms of import competition that needed special measures, special systems of protection, and that such selective measures — measures of "contingent" protection — were very much preferable to raising tariffs. Thus William Stevens Fielding, Laurier's great minister of Finance, invented the Canadian anti-dumping system as an alternative to a general increase in tariffs. This approach has really been carried forward to its logical conclusion in the U.S. Trade Agreements Act of 1979.[69]

But the existing contingency policies should be recognized for what they are: they are a political price that national governments have had to pay to reduce the opposition of powerful domestic groups against freeing trade from other import restrictions. I certainly would not wish to agree with Grey if by saying that "there were forms of import competition that needed special measures, special systems of protection" he means to imply that the existing contingency policies are needed to safeguard the national welfare of the importing country. As has been shown in section 2 above, it is quite possible that measures of contingency protection on balance reduce national welfare, and in any event they are more costly than domestic remedies would be.

While political opposition against trade liberalization must be acknowledged as a constraint preventing the use of efficient forms of intervention, it should also be realized that the importance of this constraint (and the cost of overcoming it) very much depends on the density of the smoke screen surrounding the purpose and effects of contingency protection. In the present state of affairs, not many policy makers (let alone members of the general public) may, indeed, be aware that the country is paying a price for general trade liberalization by strengthening measures of contingency protection. Or the price may appear much smaller than it really is because little is known about the cost to society of measures of contingency protection.[70]

Furthermore, at this stage of the liberalization process, it is not obvious that a system of supposedly selective measures of contingency protection is less costly for an importing country than the remaining regular import tariffs would be. As has been shown in section 2(A) above, regular import tariffs generally cause fewer by-product distortions than interventions that force or encourage foreign suppliers to raise their export prices. The magnitude of the by-product distortions caused by the remaining regular import duties could be smaller also because contingency measures aimed at preventing abnormally cheap imports tend to imply much higher rates of protection. Moreover, it is fallacious to believe that the protective effects of the existing contingency procedures are by their nature selective and of short duration. Whether they are or not depends greatly on the importing country's enforcement activities, which may provide largely invisible long-term protection by causing the above-mentioned deterrent effect.

It would appear that the deterrent effects are likely to be small if contingency measures are implemented rarely and not normally retroactively, because in such circumstances foreign suppliers and domestic buyers will often be willing to take a chance. Unfortunately, it is not generally possible to judge the deterrent effects of contingency procedures by simply observing the frequency and duration of their application, as the evidence may be ambiguous. If the mere existence of contingency procedures had an absolute deterrent effect, one would, of course, never observe their application, or would observe it only when a misunderstanding had occurred.[71] The evidence suggests that in the United States, Canada, and the European countries the deterrent effect is not nearly absolute, since the procedures have been put to the test in numerous cases. Institutional details of their implementation provide further clues suggesting that the mere existence of contingency procedures does not have a very serious deterrent effect, unless an industry has previously been "sensitized" by implementing measures. If the deterrent effect of the mere existence of contingency procedures was large enough for domestic producers to feel well protected against all abnormally cheap imports that could be prevented under the law, there would be no need for implementing procedures that establish the threat of material injury for specific domestic production in advance; there would be no need for such findings of the Anti-Dumping Tribunal to remain in force for many years after the actual dumping had occurred; there would be no need for general monitoring systems, trigger-price systems, fast-track procedures, price undertakings, and anti-surge mechanisms putting foreign suppliers and domestic buyers on notice that the importing country will swiftly implement countervailing contingency measures if foreign competitors pass some specified (or unspecified) threshold of aggressiveness.

It may, therefore, be safe to conclude that deterrent effects are insignificant for industries that have not been sensitized, that is, the implementation of contingency measures, if it occurs at all, is sporadic, of short duration, and not retroactive. On the other hand, industries such as steel and heavy electrical equipment that have a history of sensitizing implementation of contingency protection can probably expect to benefit from deterrent effects, that is, abnormally aggressive import competition is being prevented with a minimum of enforcement activity.[72]

Contingency measures of protection eliminate or reduce exactly those forms of foreign competition that domestic producers fear most and that are not attenuated significantly by regular tariffs at current levels. It is much more difficult for foreign competitors to penetrate a national market if they are prohibited from paying an "entrance fee" because the anti-dumping law of the importing country prevents them from charging lower than normal prices, or if the market share of aggressive imports must remain below the "injurious" level. For these reasons, it is understandable that domestic producers fearing aggressive foreign competition may be more interested in raising the deterrence level of contingency procedures than in retaining regular forms of protection. This should be kept in mind when the recent proposals for post–Tokyo Round changes in Canadian import law are considered. More is at stake for Canada than "to equip itself to take full advantage of its rights under the GATT. . . ."[73]

In section 2 of this paper it has been shown that economists can conceive of various reasons why governments might wish to intervene when imports become "abnormally cheap." The efficiency (national welfare) rationale of the existing forms of contingency protection, however, has been found wanting. At best, efficiency considerations appear to be irrelevant to current procedures. Yet is is more likely that notions of national welfare serve as a smoke screen camouflaging the purpose of existing contingency policies. That purpose is to protect the income positions of domestic producers by forcing up import prices even though alternate forms of intervention would be less costly for the country as a whole. I must agree with my critic, Keith Acheson, that what matters for "a policy's political potency is not how well off each individual will be after the policy is implemented, but how each voter *perceives* the effect of policy on welfare."[74] Furthermore, I share his opinion that purely theoretical papers "will do little to alter the political potency of the policy." They are merely an essential first step. "Effective reform, then, must take an institutional orientation, and appropriate revisions of the decision-making process must be devised to counter the bias" in voters' assessment.[75] That is exactly what I shall try to do next.[76]

Notes

[*] I am indebted to the Social Sciences and Humanities Research Council of Canada for funding a larger research project on anti-dumping policy of which this essay forms a part. I would also like to acknowledge helpful comments by Jack Quinn and Tony Owusu-Gyapong.

[1] The terms "contingent protection," "contingency measures" or "stand-by protection" have been used previously by Rod Grey to describe the discretionary import-restricting devices that have become more prominent since the 1970s. See Rodney de C. Grey, "How to Deal With U.S. Import Law," *Financial Post* (a three-part series: 24 November, 1 December, 8 December 1979); and "The General Agreement After the Tokyo Round," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982). The Canadian government has preferred to call these devices "special import measures." See Canada, Department of Finance, *Proposals on Import Policy: A Discussion Paper Proposing Changes to Canadian Import Legislation* (including draft legislation for a Special Import Measures Act) (Ottawa: Minister of Supply and Services Canada, 1980).

[2] In this paper, I do not intend to adopt any specific legal definitions of such terms as "unfair trade" or "serious injury," as it is sufficient for my argument to use these terms in a way that is generally descriptive of the policy approach taken by the United States, Canada, and the European Community.

[3] For details see Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970), Chapters 10 and 17.

[4] For a succinct review of the principal contributions to the domestic distortions literature, see W.M. Corden, *Trade Policy and Economic Welfare* (Oxford: Clarendon Press, 1974), pp. 2–5, 40–41. For perhaps still the most important single article, see Harry G. Johnson, "Optimal Trade Intervention in the Presence of Domestic Distortions," in *Trade, Growth, and the Balance of Payments*, Essays in Honor of Gottfried Haberler, by Robert E. Baldwin *et al.* (Amsterdam: North-Holland, 1965), pp. 3–34.

[5] Producers' surplus is defined as the difference between the total revenue obtained from selling a particular quantity of output and the corresponding area under the supply curve. At price P_1, producers' surplus equals the area of triangle SMP_1. At price P_2, producers' surplus is represented by the area of the smaller triangle SKP_2. The area of the hatched trapezoid, P_2KMP_1, thus indicates the reduction in producers' surplus resulting from the price reduction.

[6] While we shall consider the case of rigid factor prices, it should be pointed out that no simple graph can take into account all potential effects on workers' income that might result from abnormally cheap importation in a real-world institutional environment. Unemployment insurance benefits, company or union benefits for laid-off workers, income tax averaging provisions, etc., would also have to be considered.

[7] It should be recalled that I have assumed for the present case that there are no other distortions in addition to the distortion in income distribution. The SS^1 curve thus represents the marginal private and social cost of domestic production, and the pre-duty price of imports, OP_2, represents the marginal social cost of importing.

[8] Taxation can, of course, cause distortions of its own. For the principle of the matter, see Robin W. Boadway, *Public Sector Economics* (Cambridge, Mass.: Winthrop, 1979), Chapters 1–3, 9–10.

[9] See W.M. Corden, *The Theory of Protection* (Oxford: Clarendon Press, 1971), pp. 206–8; and C. Fred Bergsten, "On the Non-Equivalence of Import Quotas and Voluntary Export Restraints," in *Toward a New World Trade Policy: The Maidenhead Papers*, edited by C.F. Bergsten (Toronto: Lexington Books, 1975), pp. 245–52.

[10] The transfer of income to foreign suppliers may be deliberate, as has been noted by Warren Schwartz, "The Social Costs of Intervention," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[11] For simplicity, I have assumed in the text that all foreign suppliers dump at price OP_2 and that the same suppliers sell quantity AB at price OP_1 to avoid anti-dumping action. The effects of anti-dumping measures on the importing country's welfare would be the same if those measures would eliminate all (or some) sources that could sell only at dumped prices and the remaining imports, AB, were supplied by other sources at the "normal" price OP_1.

[12] Why subsidization of exporting industries may be in the national interest of a country when importing countries do not countervail will be discussed in subsection 2(*E*) below.

[13] For the case of Canadian anti-dumping policy, see Philip Slayton, *The Anti-Dumping Tribunal*, a study prepared for the Law Reform Commission of Canada (Ottawa: Minister of Supply and Services Canada, 1979).

[14] The welfare gain consists of a reduction in the cost of quantity CB (area $KUWM$) plus the consumers' surplus on additional consumption (area of triange UVW). Obviously, the gain is larger the larger the reduction in the price of imports. The shaded triangles in Figure 2 will be explained presently.

[15] In the language of standard welfare economics, the *laissez-faire* allocation is optimal in the absence of domestic distortions, as for any pair of goods the market mechanism results in equality of the domestic marginal rate of transformation, the foreign marginal rate of transformation, and the domestic marginal rate of substitution (DRT=FRT=DRS). For a detailed discussion, see Jagdish N. Bhagwati, "The Generalized Theory of Distortions and Welfare," in *Trade, Balance of Payments and Growth*, edited by J.N. Bhagwati *et al.* (Amsterdam: North-Holland, 1971), pp. 69–90.

[16] See, for example, Putnam, Hayes and Bartlett, *Economics of International Steel Trade: Policy Implications for the United States*, and *The Economic Implications of Foreign Steel Pricing Practices in the U.S. Market*, prepared for the American Iron and Steel Institute (Newton, Mass.: 1977 and 1978). For a penetrating critique of this argument, see Michael Trebilcock and John Quinn, "The Canadian Antidumping Act: A Reaction to Professor Slayton," *Canada–United States Law Journal* 2 (1979): 101–15.

[17] For a detailed discussion of the problem of the optimal size of capacity in cyclical markets, see Klaus Stegemann, *Price Competition and Output Adjustment in the European Steel Market* (Tubingen: J.C.B. Mohr, 1977), pp. 290–305.

[18] Those rates are optimal, as for output rate OA the marginal social cost of domestic production equals the marginal social cost of importation, and for consumption rate OB

the marginal social value of the product equals both the marginal social cost of domestic production and the marginal social cost of importation.

[19] An ordinary import tariff would also avoid the extra cost of foreign price increases. As such a tariff, by definition, would affect all imports, it would distort the price of normal imports bought by buyers who are not short-sighted. The volume of such imports would thus be reduced to a suboptimal level.

[20] On this point, see Federal Trade Commission, *The United States Steel Industry and Its International Rivals*, staff report of the Bureau of Economics (Washington, D.C.: Government Printing Office, 1978), Chapter 8.

[21] For comparison, see Schwartz, *op. cit.*

[22] Such allocation is common during boom periods in industries with administered prices that are kept below short-run equilibrium prices.

[23] The marginal social opportunity cost of labour is defined as the social value of goods and services that workers would produce elsewhere if they were laid off by the import-competing industry.

[24] The position of TT' in relation to SS' is essentially arbitrary. The argument in the text applies for any TT' curve that lies below SS'. It will become apparent later why drawing TT' through point L helps to keep the diagram simple.

[25] For a more detailed discussion of this case, see Corden, *Trade Policy and Economic Welfare*, Chapters 2–3; and also Michael Michaely, *Theory of Commercial Policy* (Chicago: University of Chicago Press, 1977), Chapter 2.

[26] Triangle KLM, that represented the other triangle of waste in the context of Figure 1, has not been shaded in Figure 3 as in the present context that triangle does not represent a waste of resources when the price of imports is raised from OP_2 to OP_1. The reason is, of course, that in Figure 3 the marginal social cost of domestic production for the incremental output, CA, lies *below* the marginal social cost of importation by assumption. Such a price distortion did not exist in the case of Figure 1. The area of the hatched rectangle $LUWM$ has the same meaning in both graphs; it will be referred to later in this subsection when measures of contingency protection are compared to an ordinary import tariff.

[27] Concerning the assumptions underlying the domestic distortions approach, see Corden, *Trade Policy and Economic Welfare*, Chapter 3.

[28] In the case of Figure 3, it is obvious that domestic buyers are better off with a subsidy that corrects the domestic price distortion than with a tariff. The buyers' total gain is represented by area P_2VWP_1. Domestic producers receive about the same net income under both types of intervention. In the case of a tariff, producers' net income is represented by the area of triangle SMP_1. In the case of a subsidy on the use of over-priced inputs, producers' net income is equal to the area of triangle TLP_2.

[29] The relationship between wage rigidity and the free-trade doctrine has been developed in Gottfried Haberler, "Some Problems in the Pure Theory of International Trade," *Economic Journal* 60 (1950): 223–40; and in Johnson, "Optimal Trade Intervention. . . ."

[30] On the asymmetry of market adjustment, see Tibor Scitovsky, "Asymmetries in Economics," *Scottish Journal of Political Economy* 25 (November 1978): 227–37.

[31] More specifically, with the price of imports at its normal level, OP_1, the socially optimal rate of domestic production in Figure 3 would correspond to the point where the marginal social cost of domestic production (the height of the TT' curve) equals the marginal social cost of importation (OP_1).

[32] To minimize the number of new points in Figure 4, I have chosen OP_3 to equal CN. It should be noted, however, that the argument in the text applies to all price reductions that are larger than the vertical distance between TT' and SS' at the normal output rate, as long as the import price remains above OT (or $LM < OP_1 - OP_{new} < TP_1$). For a

price equal to OT or less, the optimal new domestic rate of production would be zero. For a price equal to OP_2 or larger, the socially optimal rate of output coincides with the normal rate, OA. The socially optimal rate cannot be larger than the normal rate, since we have assumed that the short-term divergence between TT' and SS' occurs only to the left of the normal rate.

[33] As previously, we ignore the administrative cost of an intervention because it cannot easily be represented in the diagram. The comparison of alternative forms of intervention is, of course, affected only by *differences* in the administrative cost, including the social cost of financing subsidies, etc.

[34] Klaus Stegemann, "The Rationale of Antidumping Protection for the Steel Industry," Discussion Paper No. 321 (Kingston: Queen's University, Institute for Economic Research, 1978). See also *Proceedings of the Eighth Annual Meeting of the Illinois Economic Association* (1978), pp. 77–90; and Klaus Stegemann, "Domestic Monopoly as a Domestic Distortion Under Free Trade Conditions," Discussion Paper No. 379 (Kingston: Queen's University, Institute for Economic Research, 1980).

[35] Note the implications for the customary distinction between export subsidies and domestic subsidies, as in John J. Barceló III, "The Two-Track Subsidies Code — Countervailing Duties and Trade Retaliation," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982). Compare also the discussion of subsidies by Melvyn B. Krauss, *The New Protectionism: The Welfare State and International Trade* (New York: International Center for Economic Policy Studies, 1978), pp. 76–91.

[36] Alternatively, one might say injury caused by this country's exports cannot be serious as it represents a small share of the world market.

[37] In the case of domestic demand being given by DD' and the world market price OP_2 in Figure 5, government intervention that increases output from OF to OI would replace imports FG in addition to creating exports equal to GI.

[38] See Klaus Stegemann, "State Trading and Domestic Distortions in a Mixed World Economy," in *State Trading in International Markets*, edited by M.M. Kostecki (London: Macmillan, 1982), pp. 161–88.

[39] See, in particular, Jean-Luc Migué, "Trade Barriers, Regulation, and Bureaucratic Supply as Alternative Instruments of Wealth Transfers," and Warren F. Schwartz, "The Social Costs of Intervention," both in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982). See also Klaus Stegemann, "The Rationale of Antidumping Protection . . . ," in *Proceedings of the Eighth Annual Meeting of the Illinois Economic Association*, pp. 77–90.

[40] See Corden, *Trade Policy and Economic Welfare*, p. 54.

[41] *Ibid.*, pp. 55–56 (emphasis in original).

[42] *Ibid.*, p. 56.

[43] Bruce M. Owen and Ronald Braeutigam, *The Regulation Game* (Cambridge, Mass.: Ballinger, 1978), p. 20. A similar idea is expressed by Corden's concept of a "conservative social welfare function." See Corden, *Trade Policy and Economic Welfare*, pp. 109–12.

[44] Owen and Braeutigam, *op cit.*, p. 26.

[45] *Ibid.*, p. 30.

[46] R.S.C. 1970, Chapter A–15, section 16(1).

[47] See also Barceló, *op. cit.*

[48] The same provision also covers the case of dumped imports "materially retarding the establishment of production in Canada of like goods." That clause reinforces my point, except that it has rarely been applied.

[49] Anti-Dumping Tribunal, *Rules of Procedure*, pursuant to section 25(1) of the Anti-dumping Act (Ottawa: The Tribunal, 1974), section 11.

[50] The matter of domestic price distortions has come up on occasion, when the representative of importers argued that domestic producers had been manufacturing their own misery by refusing to reduce prices that included a high profit margin. The Tribunal refused to consider that line of defence.

[51] For the latest list of cases, see Anti-Dumping Tribunal, *Annual Report 1980* (Ottawa: Minister of Supply and Services Canada, 1981), pp. 42–51.

[52] Department of Finance, *op. cit.*, p. 1.

[53] For a report that the legal literature generally regards dumped and subsidized imports as "wrongful imports," see Barceló, *op. cit*.

[54] *Webster's New World Dictionary of the American Language*, college edition (Cleveland: World Publishing Co., 1964), p. 752.

[55] The growing importance of contingency protection is just one manifestation of a general mood asserting what Tom Courchene has called "proprietary rights to the status quo." Thomas J. Courchene, "Towards a Protected Society: The Politicization of Economic Life," *Canadian Journal of Economics* 13 (November 1980): 556–77.

[56] Owen and Braeutigam, *op. cit.*, pp. 18–35.

[57] For a summary of the debate, see F.M. Scherer, *Industrial Market Structure and Economic Performance*, 2d ed. (Chicago: Rand McNally, 1980), Chapters 11, 12, and 21.

[58] Barbara Epstein, "The Illusory Conflict Between Antidumping and Antitrust," *Antitrust Bulletin* 18 (Spring 1973), p. 1. Concerning the undeniable conflict between existing anti-dumping policies and antitrust policy, see Stanley Metzger, "The Anti-dumping Code and the Trade Agreements Act of 1979," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[58a] Jacob Viner, *Dumping: A Problem in International Trade* (New York: Kelley, 1966), p. 93.

[59] For a recent, and rare, example, see Ronald Anderson's column in the Toronto *Globe and Mail* (7 April 1981), under the revealing headline "UAW in Poor Position to Whimper for Help."

[60] The term "strategic behaviour" does not necessarily imply a conspiracy among domestic producers to put pressure on the government. Essentially the same effect results if domestic producers habitually avoid price cutting in the domestic market for other reasons such as preserving peaceful relations among domestic competitors, since habitual pricing practices are not likely to be independent of producers' and buyers' expectations concerning the government's willingness to restrain aggressive import competition. The same applies, of course, for the degree of determination with which import-competing employers resist the demands of organized labour.

[61] While non-competitive domestic prices and wages may be eroded by aggressive import competition, it is quite unlikely that domestic price distortions (and especially short-run distortions) will generally disappear without government intervention under conditions of free trade. For a more detailed discussion of this point see my earlier papers, especially "Domestic Monopoly as a Domestic Distortion," sections 4 and 5.

[62] See Stegemann, "State Trading and Domestic Distortions. . . ."

[63] It appears that established importers in many cases are content with the existing system because they would also suffer from "unfair" competition of dumped imports that often are not marketed through the traditional channels. Furthermore, it is possible that importers earn higher profits by charging a higher absolute mark-up on a smaller volume of dumped imports.

[64] For a critical presentation of the procedures under the Canadian anti-dumping system, see Slayton, *op. cit.*

[65] Again, see Owen and Braeutigam, *op. cit.*, pp. 18–35, and Courchene, *op. cit.*

[66] Courchene, *op. cit.*, p. 564 (emphasis in original).

[67] Trebilcock and Quinn, *op. cit.*, p. 115.

[68] Why the GATT sanctions the use of contingency protection has been discussed in earlier papers. See Stegemann, "The Rationale of Antidumping Protection . . . "; "Domestic Monopoly as a Domestic Distortion . . ."; and "State Trading and Domestic Distortions. . . ."

[69] Grey, "How to Deal With U.S. Import Law," (24 November 1979). See also Viner, *op. cit.*, pp. 192–93.

[70] For a partial estimate, see the study by Glenn P. Jenkins, *Costs and Consequences of the New Protectionism* (Ottawa: The North-South Institute, 1980) on the cost of special measures of protection for the Canadian textile industry, and the five case studies on U.S. import restrictions in Morris E. Morkre and David G. Tarr, *The Effects of Restrictions on United States Imports: Five Case Studies and Theory*, Staff Report of the Federal Trade Commission (Washington, D.C.: Government Printing Office, 1980).

[71] Alternatively, industries that experience little application of contingency procedures may be industries that rarely suffer from abnormally aggressive import competition for various other reasons, and the deterrent effect of contingency procedures may not matter.

[72] The significance of deterrence effects also depends on the concentration of foreign supply. Firms or countries with large market shares are more likely to restrain themselves in view of the importing country's determination to apply its contingency procedures.

[73] Department of Finance, *op. cit.*, p. 1.

[74] Keith Acheson, "The Efficiency Rationale of Anti-dumping Policy and Other Measures of Contingency Protection: Some Further Reflections," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[75] *Ibid.*

[76] See Klaus Stegemann, "The Net National Burden of Canadian Antidumping Policy: Turbines and Generators," Discussion Paper No. 453 (Kingston: Queen's University, Institute for Economic Research, 1981); "Proposals on Import Policy," testimony to the House of Commons Sub-committee on Import Policy, *Minutes of Proceedings and Evidence of the Sub-committee on Import Policy*, 23 January 1982; and "Special Import Measures Legislation: Raising the Deterrence Level," Discussion Paper No. 459 (Kingston: Queen's University, Institute for Economic Research, 1982).

The Efficiency Rationale of Anti-dumping Policy and Other Measures of Contingency Protection: Some Further Reflections

3

by
Keith Acheson

Criticism to economists is like noise to children. It is fun, and the fun increases as the discomfiture of others rises. To discipline the subsequent detailed comments on Professor Stegemann's paper and to avoid random noise, a preliminary analysis of the role of economists as policy critics and innovators is appropriate.

It is commonplace for economists to castigate the government for its policy choices. Every day in learned discussions over coffee, students and colleagues are informed of the stupidity of decision makers. Government policy makers fail to see that allowing oil prices to rise to the world level while simultaneously imposing appropriate fixed sum taxes on producers is more efficient than present energy policies; they are unaware of the bankruptcy of incomes policy; they have failed to absorb the latest calculation of the optimal fiscal policy stance. The examples of assumed government incompetence are legion, and indeed it is difficult to discover an area where academic monitors of the government process believe that policy is efficient unless, as consultants, they played a role in the design of that policy.

As individuals, economists may curse at their automobile, when it curls up and dies on the up ramp to the expressway, but, although much may be said at coffee about the lemon one bought, and embarrassment may be shown for not caveating sufficiently as an emptor, little is heard of the inefficiency of the automotive industry. In our daily lives, we observe many instances of both private and public suppliers not living up to an ideal standard. Why are we professionally disposed to accept the private sector's failure to provide ideal goods? Implicitly, we assume that there are disciplining forces operating on private suppliers which ensure that, over time, those who supply poorer quality at the same price will be driven out of business. In cases where impersonal rivalry fails to provide an optimal quality, other voluntary arrangements would spring up — continuous trading relations, co-operatives, vertical or horizontal integration, and so on. It is a belief in the salutary effects of competition either among suppliers in markets, or between markets and other voluntary arrangements for organizing the production and distribution of a service or good, that lies behind the attitude.

The same economist who ended up hitchhiking to work will follow the story of his commuting travails with a denunciation of the government's inefficient attempts to correct for automotive externalities through imposing emission controls and safety standards. Disenchantment with a particular outcome is more likely to be generalized to a condemnation of the process of public rather than private provision. One possible reason for this asymmetry is that economists do not ascribe the same properties salutary to the political process as a supplier of policy that they do to competitive supply in the private sector. Although it is not often clearly articulated, the rationale for this conclusion depends on a belief that there is a systematic bias in the political process that is absent from the private. Since it is later argued that the basic premise for this position is questionable, the implications for the role of policy criticism will be examined both when the bias exists and when it is absent.

The political market differs from the markets for private goods like automobiles. For example, the right to govern is not shared among the contestants in the same manner as the market for automobiles is shared among the Big Three, American Motors, and foreign suppliers. The supply process for government policy is not well understood, but there has been increasing attention paid by public choice economists to examining the explicit and implicit constraints that govern our governors. As industrial organization economists analyse the connections between structure, conduct, and performance for industries, public choice theorists analyse these connections for the governing process, and with the same intent of shedding light on what structural or constitutional changes, if any, would be efficient. It is from this perspective that the following comments are offered.

If we knew how to design a better car than General Motors, we could test that belief, by selling the design to a competitor or by entering the business. Why can we not sell our better ideas to political parties, or, since we appear eager to provide them for free, why are they not embraced by those parties, since they could deliver a better product by doing so? Is the failure to adopt new techniques, earnestly advocated by academic social engineers, an indication that there is little effective competition in the political system? A Marxist would certainly argue that the apparent competition is cosmetic, and only options that are in the interest of an élite are on the agenda. I disagree with this view because the combined effect of the prohibitive costs of controlling information in our societies, the secret ballot, and the universal franchise make it costly for the élite to achieve such control. Even if it did, there are many policy options that would serve the interests of the élite. Parties would be under competitive pressure to provide the policy package that efficiently serviced the dominant social group. I would argue that political rivalry not only exists, but is intense, and there would be no shortage of takers for better policy packages. The political parties have much to gain by adopting better means of coping with inflation, of dealing with acid rain, or of alleviating poverty. Presumably, the reason why many of our ideas are not embraced is that they are not considered better by the producers of policy.

By a better policy socially, economists mean that no one's welfare is lower than it is possible to make it, given the welfare of others.[1] To the suppliers of policy, on the other hand, better or more efficient policy means policy that receives wider electoral support; the critical element in judging a policy's political potency is not how well off each individual will be after the policy is implemented, but how each voter *perceives* the effect of policy on welfare. An efficient policy is one that increases votes by making more citizens believe that they have been enriched, either spiritually or materially, as a direct result of the policy. Some commentators[2] have argued that the policies that maximize votes will not be Pareto efficient because voters systematically underestimate the indirect effects of policy. In this view, the invisible hand fails to work, and indeed has a propensity to stray into the pockets of the least aware group of taxpayers.

An example may help clarify the point. Under certain circumstances, an economist would argue that a *laissez-faire* policy would result in a Pareto efficient outcome — an outcome where no voter could be made better off without making another one worse off. Through manipulating endowments of wealth, a party adopting *laissez-faire* could, in this world, dominate, or at least match, the outcomes of other parties. In a world with imperfect information, it has been argued that the political party implementing this Smithian policy would find few citizens who would attribute their well-being to the government's action. After all, the government is not doing anything except defining and enforcing transferable property rights. The voter must analyse a general equilibrium model and solve it to understand that under alternative arrangements where income directly attributable to government action exists, there is a more than offsetting reduction in income that is indirectly attributable to government action. In the electoral competition, the *laissez-faire* party faces a marketing problem in persuading customers that its product is better. The more abstract and indirect the benefits of a policy, the less efficient and attractive is that policy from the party's perspective.

If this bias of underestimating indirect effects existed in the political process, the proliferation of discretionary and non-discretionary instruments in the policy portfolios of North American governments, of which non-tariff barriers are a part, could be seen as a rational response by parties to their competitive situation. In this world, policy with a lower net benefit than alternatives, but with more easily calculable benefits than costs, can be more politically potent than those alternatives.

What are the consequences if the required bias in voters' assessments exists? To identify the indirect costs involved in policies, as Professor Stegemann has for many variants of non-tariff barriers, even with the greatest clarity and skill, will have little effect because they will do little to alter the political potency of the policy. A handful of readers may be influenced, but the electorate at large will not be. Effective reform, then, must take an institutional orientation, and appropriate revisions of the decision-making process must be devised to counter the bias. Of course, such revisions must not entail more than offsetting costs; otherwise we would be better off living with the bias.

The key to this conclusion concerning the appropriate orientation for effective social research is the existence of the bias, which can be economically corrected by reform at the political level. If it exists, then observed policy choices will be inefficient, and one can talk of political failure in the same way that economists describe a situation where a market provides a sub-optimal outcome as market failure. Without such a bias, one cannot argue that the process of political competition results in an inappropriate choice of instruments.

The a priori argument for a bias is not that robust. That indirect costs or benefits are difficult to estimate even for professional economists is definitely true, but the argument for inefficiency requires that the guesses about their size be systematically under their true value. That the variance of a voter's guess would be very high follows from the primitive nature of a voter's knowledge about the effects of policy, but it is plausible that the voter is as prone to overestimate as to underestimate. Are the estimates made by the uninformed concerning the indirect costs of nuclear power, or of adjusting to higher oil prices, or of the effects of pesticides too low? I, for one, would have to be convinced by empirical proof that this was the case, since I see no logical reason why it would be, and casual empirical observation indicates that it is not.

Indeed, in modern macro-economics, the rational expectations school assumes that individual decision makers have *unbiased* predictive models for the results of macro policy initiatives. The private decision makers' models may be trivially simple compared to the huge econometric models available to the central bank, or the finance department. However, the startingly different policy conclusions of rational expectations will still hold as long as these simple models are not biased.[3]

Estimating the total costs and benefits of a policy requires the voter to predict causally related changes and evaluate them. How are the predictive models of individuals formed? Little is known in this area, but a few speculative comments can be made. Relatively few individuals have a sophisticated knowledge of how the economy operates. Inferences about effects are often arrived at as a result of media coverage and peer discussion. A party that proposes a policy and its competitors have an interest in influencing the beliefs of voters about the effects of policy. Partisan claims, either explicit or implicit, about the structure of the economy are supplied by political parties in a tied package with their policy programme. Whether or not unbiased estimates by individual voters emerge from this process is a moot point, but it is not obvious that a systematic bias emerges.

Economists frequently distinguish between policies that are potentially Pareto improving and distributional policies. If there is no bias in the estimation of indirect as compared to direct effects that it would be worthwhile altering political institutions to correct, we have argued that the competitive political outcome will be a Pareto efficient set of policies. Where it is possible to make someone better off and no one worse off, a political party will seize the opportunity. Such opportunities are truly free lunches. Political competition then leads to searching among these Pareto efficient possibilities for an income distribution that provides maximum electoral support. In modelling this competitive process, instability often results, and there may be no set of policies that can sustain a majority.

Leaving aside such problems, what are the implications for economists and other analysts of policy if the process of determining policy combinations is an efficient one? If everything is optimal, what role is left for the social critic? The role of the economist is altered by this changed perspective, but a role remains. Policy is optimal given the knowledge available at the time, but economists and other social scientists are expanding the analytical and empirical knowledge base concerning the impact of different policy options. After all, the financing of economic research is revealed as part of the optimal policy package. The economist then is part of the social research and development establishment that provides the ideas for new policy packages to existing and potential parties.

The essay presented by Professor Stegemann falls into the second category, that is, out of the policy research and development lab, and does not address deficiencies in the decision-making process. Stegemann identifies, with characteristic thoroughness, the different costs and benefits involved in implementing a non-tariff barrier (ntb). By introducing a 'domestic distortion', the net costs associated with an "ntb" may be transformed into a net benefit, although, generally, other policy instruments will provide even greater benefits in the situations depicted, and, in many cases, the *status quo* is preferable. If the *status quo* is inferior and other superior policies cannot be adopted, the ntb emerges as the best of the eligible policies, and is efficient.

Economists have labelled such a justification for a policy instrument as a second-best argument.

Two other points are noted by Stegemann. The ntb's that are traditionally employed distribute some income to foreigners in addition to affecting domestic allocations and distributions, and frequently there are variants of the instrument that would not benefit the foreigner, and that are not chosen. Why? The second important point is that the ntb will alter the behaviour of the foreign suppliers. For example, threatened by anti-dumping, the foreigners form a cartel to sell at the acceptable price and collect for themselves the implicit anti-dumping tax. An important corollary of this, which is often missed in statistical research, is that there may be little correlation between some index of policy, such as the number of anti-dumping cases, and the resource allocative effect of anti-dumping policy. Indeed, it may be very difficult to identify the social costs of a policy without information on costs and prices of foreign suppliers for all industries influenced by the *threat* of action. Such information is not available, or likely to become available.

I would expect behavioural responses to policy that extend beyond those mentioned in the essay. Once a pattern of interpretation of policy, for example, dumping, in the country evolves, exporters will adopt complex price strategies that will not be legally judged as dumping, but that will continue to pursue the objective of increasing the exporters' sales and profits by effectively lowering the costs of doing business with them. More favourable credit terms, lower prices on other export business, the purchasing by the exporter from the importer of some other products at inflated prices, ancillary consulting fees, and so forth, are likely to proliferate. The exporters will also price in their domestic markets or at least record prices, so as to lessen their chances of being effectively prosecuted for dumping. Vertical and horizontal integration nationally and across borders, that is, the expansion of large firms and multinationals in particular, will be encouraged, since the terms of intra-firm exchange are much more difficult to monitor.[4]

The effects on the domestic industry will be considerable as well, particularly because of the contingent nature of policy. The contingencies are not states, or events of nature that the interested parties cannot affect through their behaviour, and an obvious moral hazard problem arises. If one rewards injury, more will be supplied. If one rewards serious injury more than plain injury, an incentive to let the latter become the former is created. If laying off workers increases the chances of launching a rescue mission by the guardians of the public purse, that form of adjustment to adversity will become more attractive, and we will observe more, not fewer, lay-offs than we otherwise would.

Governments will not just cease and desist from subsidizing exports because of the threat of countervail but will seek more clandestine, and presumably less efficient, ways of pursuing the relevant objective. Predicting such substitution is the meat and gravy of economics, although some economists have become so enamoured with arithmetic that the behavioural basics of the discipline are sometimes obscured. Ambassador Grey mentioned that the early architects of the GATT were surprised that other instruments were substituted for tariffs when tariffs were reduced. A call to the economist in the research and development shop should have disabused them of their optimism. I would go further and argue that to the extent that the new ntb codes are successful, new ntb's will emerge.

Professor Stegemann's analysis of the possible efficiency of ntb's when distortions exist domestically is a straightforward application of second-best theory. The premise on which the second-best theory is based, however, is questionable.[5] The distortions that are in practice taken as being inviolable are not natural ones, but are the result of policy themselves. Stegemann's list, for example, includes labour unions, minimum wage laws, and equivalent agreements and conventions. Presumably, these constraints are inviolable because they are serving some politically legitimized purpose that is not to be undermined, but the rationale of second best is to shape the rest of the economy so that the inviolable constraints are offset as much as possible. In making decision two, doing one's utmost to undo the effects of decision one is a silly way to proceed.

Policy analysis often focuses on the characteristics of an instrument in isolation, and relevant aspects of why it exists may be missed by such myopic examination. An ntb may be tailored to distribute some income to some foreigners in order to reduce the probability of costly retaliation, or because foreigners are making a similar transfer when they invoke such policies, or because a quid pro quo is being realized in a completely different policy area. Canadian-American policy interaction is so complex that it is a mistake to judge whether there is a balance in any particular area. To ask, did we gain from a particular GATT negotiation, seems irrelevant, unless we have to compartmentalize our monitoring of public agents to make it effective. A change in the tax treatment of business conventions in one country may be implicitly connected with the commercial deletion policy of a broadcast regulator in another, and so on.

Two further comments may be appropriate. It is ironic that in a period where deregulation is being actively discussed and some tentative steps are being taken in that direction domestically, the reverse seems to be true internationally. How the regulation of international trade will differ from that of domestic trade is an interesting area for speculation. The decision-making process is different, but how that decision-making structure will evolve as the imperatives of regulatory adjudication and enforcement feed back on it is another cloudy area in the crystal ball. Lastly, if economists are to provide a research and development role, I believe the development side should receive more stress. Unlike its industrial counterpart, social research and development is long on basic research and short on development. The area that has been most neglected, in my opinion, is the analysis of how specific policy proposals have in fact worked in the past, and what adaptations have taken place as experience identified where our expectations of effects were wrong. With new policy proposals, more analysis of their proposed concrete institutional and legal manifestations should be undertaken, as it is by Professor Stegemann and other contributors to this volume.

Notes

[1] Not as innocuous a standard as it may appear, since, by itself, it begs the question of distribution. As Sen has noted, "a society can be Pareto-optimal and still be perfectly disgusting." Amartya Kumar Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, 1970), p. 22. Other difficulties with the concept as a guide to policy are also discussed by Sen.

[2] Anthony Downs, "An Economic Theory of Political Action in a Democracy," *Journal of Political Economy* 65 (April 1957): 135–50.

[3] Thomas J. Sargent and Neil Wallace, "Rational Expectations and the Theory of Economic Policy," *Journal of Monetary Economics* 2 (April 1976): 169–83.

[4] For example, Mr. R.W. Main, Vice President, Administration, Massey-Ferguson, in testimony before the Senate Committee on Foreign Affairs, stated with respect to separating American and Canadian net income figures:

> We have so much interflow and exchange of goods and components between the United States and Canadian factories that it becomes rather a subjective, judgmental matter as to whether the profit is one place or the other. (Proceedings of the Standing Senate Committee on Foreign Affairs, 8 February 1977, p. 10:26.)

[5] Michael McKee and Edwin G. West, "The Theory of Second Best: A Solution in Search of a Problem," *Economic Inquiry* 19 (July 1981): 436–48; and Roger L. Faith and Earl A. Thompson, "A Paradox in the Theory of Second Best," *Economic Inquiry* 19 (April 1981): 235–44.

The Social Costs of Intervention

4

by
Warren F. Schwartz

I. Introduction

Implicit in any definition of social cost is some assumption of a normal or desirable state of affairs to which the outcome under consideration can be compared. I believe that the traditional method of formulating the bench-mark for making the requisite comparison omits important considerations that need to be taken into account in making judgements as to the desirability of a restriction on international trade.

Traditional analysis focuses on the dead-weight or allocative losses resulting from a tariff, quota, or other form of government intervention. These consist of the displacement of more efficient foreign production by less efficient domestic production and the substitution of other, less valued, goods by domestic consumers confronted with the higher prices resulting from the displacement.

This misallocation of resources associated with trade restrictions is, however, I believe, only one of the adverse consequences that must be taken into account. There are also costs associated with the political rivalry to secure and resist the imposition of the restrictions.[1] Moreover, implementation of the interventionist measure imposes the direct costs of administration and compliance and the adverse consequences flowing from the "perverse" incentives created by any regulatory system. These result from the efforts of people to adapt to the system by such actions as varying the design of a product to fall outside of the definition contained in a quota or to hinder enforcement as, for example, when slightly different products are made for the home and export market in order to make the price comparison required by the anti-dumping laws more difficult. Perverse incentives are also created by the possibility of error in applying the legal standard producing a "chilling" effect on conduct, which the restriction is not designed to reach but to which it may be mistakenly applied.[2]

Any useful notion of social cost will also have to take account of the benefits generated by the restriction. After all, a restriction can encourage "infant industries" or allow people to remain in their present occupation or preserve a domestic industry, which might be useful if a war had to be fought or serve any other purpose that the country deems worthwhile. The failure to realize any of these benefits is, of course, the same as incurring a cost. Thus, any notion of the social costs associated with a particular measure must represent a net calculation of the positive and negative effects associated with the adoption and implementation of the restriction.

Sorting out all of these effects is a formidable task. Two sets of interrelated issues must be resolved. First, what are the empirical dimensions of the relevant effects? Secondly, what normative value should be placed on the various consequences associated with the imposition of restraints on international trade?

The first aspect of this question, while no doubt extremely complex as a technical matter, presents no great difficulty in principle. The magnitudes of such things as the substitution in production and consumption induced by the restraint, the monetary costs incurred in implementing and complying with the restrictions, and even the perverse effects produced by the adaptive behaviour of persons affected by the restriction can be estimated. These measurements are, however, very costly to make and represent at best very crude estimates of the actual magnitudes. I have little to contribute to the technical question of quantifying consequences of this kind. I am content, for purposes of this essay, to leave the matter with the simple assertion that quantification will inevitably be very costly and substantially unreliable.[3]

The normative dimension is, even in principle, extremely difficult. If one begins, as I do, with an individualistic calculus of value, the fundamental problem is to compare the outcome produced by the government intervention with that dictated by the preferences held by the members of the society. There are profound theoretical difficulties with the concept of aggregating individual preferences into a "social welfare function," which I will put aside.[4] Instead, I will adopt a simplified approach that I believe will clarify the issues without requiring a lengthy digression into the essentials of welfare economics.

2. Co-operative versus Exploitive Processes

I will postulate that there are two essential forms of government intervention. One corrects externalities or, as it is formulated from a related but slightly different point of view, produces public goods. The basic idea here is that these are the types of measures that would emerge from private voluntary exchange if impediments to the consummation of the transactions did not exist. For example, imagine a factory surrounded by ten houses. Each year the factory produces smoke that causes each of the ten homeowners discomfort that each would pay $1 000 to avoid. At an annual cost of $500, the smoke could be entirely eliminated. Thus, there would be a net gain of $9 500 from eliminating the smoke. Nevertheless, transactions leading to the realization of this gain might not occur. Each homeowner would conclude that by paying slightly more than $500 to the factory owner, he could avoid a $1 000 loss by inducing the factory owner to eliminate the smoke. Thus advantageous trade between each homeowner and the factory owner would be possible. But each homeowner would also see the possibility of realizing the $1 000 gain without paying anything by taking a "free ride" on a transaction between another homeowner and the owner of the factory. As each homeowner holds back in the hope of having the cost of abatement borne by the other, it becomes uncertain whether any of them will ever consummate the beneficial transaction.

Government intervention, either making the factory owner liable for the damage caused by the smoke, or simply prohibiting the emission of smoke, would constitute an unambiguous improvement in the sense of getting the parties to the outcome that would have been reached if the negotiation process had not been infected by strategic possibilities. Much intervention into international trade can, in principle at least, be justified in similar terms. If, for example, there is a necessity for domestic supply in the case of national emergency, private transactions may not take this into account even if every purchaser values the national security resulting from domestic production. This value is like the smoke abatement. Each person purchasing gasoline may be prepared to pay more if it is derived from domestically produced crude oil because he values the added national security attributable to domestic production. If, however, he believes that other people share this preference, he may attempt to "free ride" by buying an imported product and letting other people bear the cost of supporting the domestic industry. There is, of course, no way anyone can buy enhanced national security only for himself through the purchase of a domestic product. This analysis extends in principle to virtually all of the rationales for intervention in international trade. If, indeed, domestic production is preferred on any ground, strategic possibilities will frustrate the expression of these preferences through voluntary transactions. Government intervention giving effect to these preferences can thus constitute an improvement in precisely the same sense as the mandated abatement of the smoke emission by the factory.

There is, however, a second basic motivation for government intervention. In this case the coercive power of the state is utilized to redistribute wealth from one group to another while reducing the aggregate wealth of the society as a whole. Thus, for example, if a government-conferred monopoly is granted, the person enjoying the monopoly will be able to charge a higher price than if competition existed. Moreover, since the monopoly price will cause substitution by consumers to less valued goods, overall wealth will also be reduced. And if the excluded suppliers are more efficient than the firm granted the monopoly, aggregate wealth is further reduced. Many restrictions on international trade have these characteristics. Tariffs, quantitative restrictions and, more subtly, anti-dumping and countervailing duty laws and other forms of intervention restricting foreign competition can enable domestic producers to charge a higher price and capture a larger share of the domestic market. The allocative effects associated with these transfers reduce overall wealth.

Increasing attention has also been given to a second set of adverse effects resulting from the effort to achieve private gain through the coercive power of the state. Real resources are employed to secure this gain and to resist the efforts of others to obtain it. If the society is indifferent to the wealth transfer achieved through government intervention, then it must regard as wasteful the utilization of resources in securing or opposing it. And, of course, if these transfers cause allocative losses as well, there is all the more reason to deplore the devotion of resources to the political rivalry. In these cases, devoting resources to enforcement of the provision also constitutes social waste.

International trade restrictions fall within both of the basic categories I have described. They can, in principle, enhance efficiency by dictating the outcome that would have been reached by voluntary exchange if it had not been impaired by strategic considerations, and they can confer benefits on favoured groups while reducing the overall wealth of the society.

In assessing the social cost of existing trade restrictions, what one needs to do therefore is to determine how well the two basic forces that produce government intervention are being regulated by the competent domestic and international institutions. Posing the issue in this fashion creates a different context than the usual perspective for evaluating legal institutions. There are, if you will, two processes — a co-operative one and an exploitive one — working simultaneously to shape government intervention into international trade. The co-operative process seeks to capture the gains resulting from efficiency-enhancing government intervention and to avoid the losses resulting from particular groups turning the governmental process to their own advantage. The aims of the exploitive process are not the precise opposite of the co-operative one. While it is true that those engaging in this activity are seeking private gain through government intervention, the waste associated with this redistribution is something they too may wish to avoid. This will depend on the extent to which they bear these costs. The imposition of the costs of intervention on its beneficiaries will emerge as one important factor in the effort to contain what I have called the exploitive process.

To know how well legal institutions are functioning, then, it is necessary to determine how they affect the realization of the co-operative[5] and the exploitive purposes. This is a subject of extraordinary complexity, but I believe some clarification is possible if one focuses on certain fundamental characteristics of the process through which these purposes manifest themselves.

The most salient feature of this process is the apparently greater efficacy with which the exploitive purpose can be pursued. This issue depends on the same phenomenon discussed above in relation to the factory emitting smoke. A government measure is like smoke abatement in that all people affected by it will capture the benefits it creates whether or not they have "paid" for it by contributing to its enactment. Thus, as in the case of private transactions with similar characteristics, there will be a tendency for there to be "too little" investment in securing the measure unless somehow the strategic opportunities to take a "free ride" can be eliminated.[6]

This phenomenon is present both in what I have called co-operative as well as exploitive legislation. It does not matter whether the benefit consists of an increase in wealth because efficiency has been enhanced, or a transfer of wealth to a favoured group. In either case there is a "prize" to be captured and no way to limit it to those who have contributed to its creation.

There are, however, means of overcoming these strategic possibilities and inducing potential beneficiaries to co-operate in "purchasing" the desired legislation. Trade associations, labour unions, consumer organizations, and any other group of persons with similar preferences can attempt to induce co-operation in support of government intervention favoured by the members of the group. In the case of intervention in international trade (and elsewhere), it is widely speculated, however, that organization to this end can be more effectively achieved in support of the exploitive purpose than in furtherance of the co-operative purpose.[7] Domestic producers and other interests like labour unions that stand to realize direct benefits from restrictions on international trade will be more effective than consumers or taxpayers who will bear the costs imposed by the legislation. Similarly, organizing taxpayers or consumers in support of intervention to serve the co-operative purpose, say an excise tax on gasoline, will be very difficult. It must be stressed, however, that no rigorous demonstration of this widely espoused view has ever been offered. It is true that the large visible stake in protection and the relatively small number of interests that need to be organized suggest that protectionist groups will be more effective.[8] On the other hand, organization of competing groups like taxpayers or consumers is also possible, although apparently more difficult. Moreover, there are some groups, like importers, who do have a direct stake in resisting trade restrictions. There is, also, a great body of legislation such as in the environmental field, or the food and drug area, which seems to be consumer oriented (whether mistaken or not) and contrary to the interests of producer groups. The supposed differential superiority of producer groups in exercising political power should have tended to lead to these bills being defeated. And, to make an obvious but essential point, the success that has been achieved by groups seeking protection from international competition, or any other form of special favour, has by no means been unlimited. Opposing forces have not been wholly powerless in the political struggle.[9]

In summary, then, we have a widespread belief, which seems plausible but is by no means conclusively demonstrated, that those seeking protection will be more effective politically than those opposing it. As a corollary, if there were a strong general interest in capturing the external benefits that can be produced by limiting international trade, this interest would be a difficult one to give effect to in the political process. For the same reason that consumers and taxpayers have difficulty organizing to oppose restrictions, they would be ineffective in supporting restrictive measures because they valued domestic production as a means of providing external benefits. For both of these reasons, then, it is likely that it has been on the whole the producers and allied interests who have succeeded in securing restrictive trade legislation, and that the principal motivation has been the direct benefits created rather than the externalities that in principle can be associated with domestic production.

One way to view the domestic and international institutional structure governing international trade, then, is as a means of counteracting the advantage that producer interests enjoy in the "normal" political process. Stating the issue in this fashion, however, reveals a range of basic puzzles and ambiguities. There exists a "normal" process through which domestic legislation is enacted. But this process itself includes such features as limitations on campaign expenditures, the presidential veto, and indeed the bicameral legislature that are designed to make the passage of "special interest" legislation more difficult. Trying to explain these provisions is itself a challenging undertaking.[10] Superimposed upon these are a number of limitations upon the "normal" political process specifically applicable to the field of international trade, which apparently are also designed to hinder the realization of what I have called the exploitive purpose. Why have these emerged and how well do they function? I offer two possible hypotheses in response to this basic issue. First, the relative efficacy of groups organizing to achieve the exploitive and co-operative purposes is different at the "constitutional" stage when rules governing the process of instituting restrictions on international trade are formulated than at the later point at which specific interventionist measures are considered. In particular, the co-operative purpose is systematically more robust at the constitutional stage. The second basic explanation is that what appear to be limitations on the power of groups to secure protection through the domestic political process are really the "price" these dominant groups have paid for enhanced influence in the domestic political processes of foreign countries with whom they wish to trade. Since, however, this enhanced influence will usually be directed to securing parity of treatment with domestic producer interests, rather than preferential status, its exercise will correspond with the achievement of the co-operative purpose through the elimination of protection in the country in question. My surmise is that these two phenomena do explain in significant measure the international limitations on domestic protection.

I will focus on these questions rather than attempt a direct inquiry into the social cost calculation I have described. I choose this approach for two reasons. First of all, as I indicated above, it seems to me inescapable that estimates of the relevant empirical magnitudes will be substantially unreliable. However, the fundamental reason I turn to this approach is because I do not believe there is any way to avoid the fact that the normative issues are embedded in the process from which the restrictions emerge. If the process is regarded as self-validating in the sense that one assumes that the measure would not have been enacted without adequate justification, the inquiry is brought to an abrupt halt. While I do not wish to accept this self-validating hypothesis, I also do not want to rule out the possibility that a measure does achieve objectives (other than direct redistribution to beneficiaries) that are embraced by people in the country imposing the restriction. Thus the key issue is the disparity between what in fact emerges and what is genuinely preferred. There is no direct way to detect, no less measure, this disparity. The best one can do is identify tendencies of the institutional structure to produce greater or lesser disparities of this kind. As I have indicated, I take as my point of departure the assumption that the "normal" domestic political process in matters of international trade regulation will give too much effect to the exploitive purpose and too little effect to the co-operative purpose. The question then becomes the extent to which the special institutional structure governing international trade is likely for either of the reasons discussed above to improve the outcome that otherwise would have been produced by the "normal" domestic political process. More ambitiously, one might ask how this institutional structure might be altered to effect an even greater improvement.

I now turn to these questions.

3. The Institutional Structure of International Trade Regulation

At the outset, in addressing the issues I have posed, one is confronted with an apparent paradox. If, as I have postulated, protectionist claims are given "too much" weight in the normal political process, why do the persons holding protectionist views not block institutional change that will reduce their ability to secure desired outcomes? In other words, if protectionist interests can secure passage of a tariff or quantitative restriction, it is because they are dominant in the political process. But the institutional structure I will describe, whether it is derived from domestic law or international agreement, could not have been established without the concurrence in one form or another of the domestic national legislature. Why then were these provisions not blocked by the forces whose power would be diminished by them?

One obvious answer to this question is that institutional arrangements that impede the imposition of restrictions on international trade have been vigorously opposed by protectionist forces. Both the limitations resulting from international agreement and those derived from domestic law that do exist are the ones that have survived this intense opposition. The interesting question is why any, and in particular those that have emerged, have been enacted given the political situation I have described.

This question seems to me a variant of an issue that has only recently begun to receive serious attention. The occasion for this new scholarly interest was the passage of Proposition XIII in California, and other state and federal measures restricting the taxing power of the otherwise competent legislatures. Although these phenomena at a superficial level seem unrelated to the questions I am considering, I believe they involve essentially the same issue. If the political process was taxing "excessively," then it must have meant that the forces opposing measures like Proposition XIII were in ascendancy. These forces are analogous to those supporting restrictions on international trade. Somehow, however, the groups that opposed the magnitude of taxation, while they could not defeat the specific measures that accomplished it, could secure general prohibitions that impaired the ability of those supporting particular tax measures to achieve their objectives. Similarly, in the case of international trade, general limitations on the ability to afford protection from international competition have been secured despite the fact that if these limitations are not meaningless, they must lead to the defeat of some protectionist measures that would have been imposed if the general limitations did not exist.

In attempting to clarify this process, James Buchanan has referred to the institutional limits on a particular type of legislative activity as "constitutional" in the sense of constraining what would otherwise have been the political outcome, or what he calls "majoritarian" result.[11] One possible explanation of the emergence of limitations on the enactment of protectionist legislation is that the co-operative purpose will fare better at this "constitutional" stage than with respect to particular pieces of legislation. One can only speculate why this might be so. Perhaps the range of cases to which the general provision applies creates a sufficiently large discrepancy in the aggregate between consumer and taxpayer benefits from defeating "special interest" legislation, and producer benefit in obtaining it, to offset any cost advantage in organizing to influence the political outcome with respect to the general restrictions that producer groups may enjoy. This conclusion would be reinforced if the wide range of applications also made organization of producer interests systematically more costly with respect to general measures of this kind than in the case of legislation with direct impact on a particular industry. This does seem plausible.

In sum, then, for these and perhaps other reasons that I have been unable to identify, it is possible that the relative political strength of the exploitive and co-operative purposes is different with respect to general "constitutional" measures than specific legislation. More pointedly, the co-operative purpose stands a greater chance of success in securing "constitutional" protection than in defeating a particular statute providing benefits to a narrowly defined group.

There is, however, a second explanation that also seems plausible. Restrictions on international trade impose costs not only on domestic consumers and taxpayers but on foreign producers as well. This group has less influence in the domestic political process simply because its members (including, of course, indirect beneficiaries like employees) cannot vote in domestic elections. Domestic producer groups, to the extent that access to foreign markets is important to them, may thus wish to increase their influence in the political process in the countries that constitute important markets. International agreements, in the case of the regulation of international trade, most significantly the GATT, can be viewed as a means for domestic producer interests to trade less success in their own political process for greater success in the political processes of foreign countries. The quid pro quo of greater influence in the foreign political process cannot take the direct form of being granted the right to vote or exercise some veto over domestic legislation. It instead takes two forms. First, general substantive limitations on the protection that can be granted by domestic legislation are imposed. Secondly, through the multilateral negotiating process, the benefits of reducing restrictions in foreign countries can be identified and political support organized in the domestic political process for the proposition that it is worthwhile to pay the "price" in reduced domestic protection necessary to secure the greater access to the foreign market. If each country addressed its own restrictions unilaterally, the value to foreign interests of having the restrictions relaxed would have less effect on the deliberative process. Viewed from another perspective, domestic producer interests seeking greater access to foreign markets become the advocates of domestic consumers and taxpayers in urging that trade barriers be lowered, not because they derive direct benefit, but because these reductions are the "price" paid for the lowering of barriers abroad.[12]

What is important for the purpose of this discussion is that the two devices I have described are explicable as rational choices to restrict a group's influence in the domestic political process in exchange for greater influence in the political process of other countries. But this exchange cannot be made in an *ad hoc* fashion as particular measures are under consideration. There is after all no essential linkage between, say, greater access to the American market for foreign textiles and greater access to foreign markets for American grain. In the absence of some institutional device that does link them, the two measures would be examined separately and the exporter interest (and derivatively the consumer and taxpayer interest) in both given less effect than if the issue were posed so that the enactment of each were dependent on the other. Substantive limitations on national trade restrictions can achieve the same objective in a different fashion. Here the trading takes the form of a range of prohibitions with the overall consequences depending on the net effect of these. Again the efficacy of these measures depends on the inclusiveness of the prohibition and the consequent ability to take into account to a greater degree than in the domestic political process the value to foreign interests of the reduction of domestically imposed restraints.

One way to look at the multilateral bargaining process and the internationally imposed substantive restrictions on national legislation are as a means of facilitating what in domestic legislation is called log-rolling. A simplified example may clarify this phenomenon. Assume some local government unit is considering two measures. There are three groups who place the following net values (that is benefit less the cost to them) upon the measures:[13]

	Measure I	Measure II
Group A	+100	− 1
Group B	− 1	+100
Group C	− 1	− 1
Overall	+98	+98

If each of these measures is voted upon separately, each will be defeated by a 2 to 1 vote. If, however, Group *A* can secure Group *B*'s support for Measure I in exchange for its support of Measure II, both measures will pass and net total benefits of 196 units realized. Vote trading between groups to achieve results of this kind is called explicit log-rolling. Suppose, however, that a candidate were developing a platform. He would favour both measures and thus be able to defeat a candidate who advocated that neither or only one of the two be passed. This is so even though a majority is opposed to both of the measures if viewed separately. A candidate's process of thus forming a platform across a range of issues to maximize his chances of winning is called implicit log-rolling.

The multilateral bargaining process in international trade can be viewed as a means of facilitating explicit log-rolling. The equivalent of Measure I and Measure II in the simplified example is reductions in trade restrictions in two different countries. Each of these measures would lose in the domestic process of the particular country if separately considered. It is important to realize, moreover, that in the absence of the linkage, the value of passage would be systematically understated, since the value placed upon it by foreign interests would be reduced by their inability to vote in the domestic political process. If bargaining across issues is permitted, these preferences will be given effect, albeit indirectly. In both domestic political processes, the value of existing restrictions will be reduced by the additional cost of forgoing the gains realizable by eliminating the restriction and achieving greater access to foreign markets in return.

Substantive international restrictions on national legislation can be viewed as the analogue of implicit log-rolling. Here, rather than having bargaining in which a range of effects can be explicitly taken into account, a general prohibition is enacted and majority support secured on the basis of the overall effect of the prohibition. This would be analogous to a result in the postulated example of mandating passage of both Measures I and II. Groups could rationally support such a provision even if it would lead in particular cases to outcomes that they would not favour and could defeat if the domestic political process were not constrained by the prohibition imposed by the international provision.

There seem to be then two essential and interrelated characteristics of the process through which the institutional structure controlling the regulation of international trade has emerged that differentiate it from the "normal" domestic process. First, it offers a means of taking a range of consequences into account. Secondly, it provides a method for giving effect to consequences upon individuals who cannot vote in the domestic political process. The preferences of these "foreigners" need not be given effect on altruistic grounds. They are being accommodated in exchange for the benefits they can secure for domestic interests in their own foreign domestic process. And as the log-rolling model makes plain, all the participants can in principle improve their positions by increasing the number of relevant effects that are taken into account and the sensitivity of the system to the intensity of preferences of interested groups.

The next question I will address is whether application of this approach to various features of the institutional structure governing the regulation of international trade yields useful insights into the forces that have shaped these institutions and the possibilities for further progress.

4. Rules Versus Negotiations

One much debated issue is the extent to which the institutions governing the regulation of international trade should be characterized by the promulgation of rules restricting the conduct of individual countries as contrasted with providing a framework within which multilateral negotiations can be conducted.[14] The distinction I have drawn between explicit and implicit log-rolling may offer a clue to the functional explanation of why one or the other of these mechanisms is employed.

As I have indicated, these two devices are alternative ways of improving the outcome by considering together a series of issues, with respect to which decision makers have different intensities in their preferences. This can be done explicitly by a series of trades in votes, the equivalent of multinational bargaining, or implicitly by dictating the outcome in advance with respect to a range of issues, the equivalent of adopting a rule of general application.

The use of these two devices must reflect their efficacy in achieving the objectives of the participants in the deliberative process. It would seem on plausible empirical assumptions that this analysis is consistent with the observed fact that, on the whole, negotiations among interested parties embracing a number of issues rather than the enunciation of controlling rules of general applications has been the method employed.

If implicit log-rolling were utilized, each country would be required to specify, in advance, criteria limiting its power and that of all other countries to act unilaterally in restricting trade. To decide if acceptance of these criteria would advance its own interests, each country would have to make a complex calculation of the benefits it would derive from the limitations imposed on other countries and the costs it would have to bear from forgoing the imposition of restraints that its domestic political process would promulgate in the absence of the international agreement. Anticipating all of the relevant effects both in the country itself and in the other participant countries is a task of formidable difficulty.

There is also a related functional difficulty. If a general standard is to be applied and each case resolved in accordance with it, the standard must have theoretical coherence if application is not to be wholly arbitrary. Thus, for example, in domestic law the negligence standard in torts is functional precisely because it does represent a coherent conception that can be applied to particular cases. By contrast, in a field like taxation where the governing rules represent a series of political compromises with no underlying theoretical rationale, the rules take the form of extremely detailed specification of the outcome in particular situations.

Restrictions in international trade in this respect resemble a tax code. Tariff and non-tariff barriers alike do not represent the implementation of some theoretically coherent rationale for government intervention. Consequently, there is no way to limit them by imposing such a rationale and prohibiting restrictions that do not satisfy its requirements.

The social value of any particular restriction is determined not by a neutral calculus but rather by the outcome of the political process. The only way to abolish such a restriction through an international institution is thus to have the domestic political process fix a "price" for its abolition and to have the interested foreign countries decide if they wish to pay.

Implicit log-rolling is more difficult when the outcome that is desired lacks theoretical coherence. If the value of the items included in the trading depends crucially on the domestic political processes in the various countries, no neutral calculation of value is possible, and, as a related matter, no standard expressing the measure of value can be formulated.

For these reasons, agreement must take the form of a series of highly particularized interdependent concessions. There is, if you will, no analogue to the choice among candidates who bundle a range of related issues into a platform so that the choice can be among candidates. The issues are too complex and the preferences too diverse for generalized solutions, the analogue of candidates with platforms, to be the means of resolution.

It is true, of course, that these tendencies are not absolute. In some cases, for example, the imposition of a countervailing duty in response to a tax remission at the border, it is possible to anticipate the relevant effects and achieve agreement.[15] All the countries may believe that across the range of cases they will gain more from not having a countervailing duty imposed than they will lose by not imposing a countervailing duty on imports from other countries. They have thus implicitly log rolled all cases and chosen the "candidate" who favours prohibition. Even here, of course, one consequence of the log-rolling phenomenon is that it is not possible to say even that the judgement has been made in balance that imposition of countervailing duties based on remissions at the border does more harm than good. It is conceivable that some of the votes for the prohibition were "purchased" by concessions on other issues. Thus one of the general conclusions flowing from the acceptance of the log-rolling phenomenon is that the meaning of every resolution is rendered ambiguous by the possibility of vote trading across issues.

The conclusions to be drawn from this section are modest but may nevertheless be useful. The form that agreement on matters of international trade takes is not accidental. The process of constraining the outcome in the domestic political process in particular cases by internationally imposed institutional limitations is driven by the same basic forces as shape the outcome domestically. International regulation provides opportunities for these forces to do even better than would be the case if each domestic political process functioned independently. The form of international regulation is ultimately determined by the efficacy of various institutional means to serve the ends of the controlling political forces. Explicit log-rolling leading to highly particularized resolution rather than implicit log-rolling, in which generic classes of outcomes are dictated, seems to be the preferred, if not exclusive, mode for achieving the ends sought by the operative political forces.

All of this, ironically, in one sense constitutes something of a victory for the co-operative purpose I referred to in the introductory section. The dominant producer interests trade less influence in their own domestic political process for more influence in the foreign domestic political process. But that influence in the foreign political process, while no doubt exercised in their own self-interest, is utilized in favour of the co-operative purpose and in opposition to the furtherance of the exploitive purpose by the domestic producers. This is so because the foreign producers have (developing countries aside) little chance to gain a preferred status as suppliers. The best they can do is secure equal opportunity to compete with domestic producers. To achieve this, however, requires the dismantling of protection for the domestic industry. If this protection in turn was the product of the exploitive purpose, then the outcome constitutes a victory for what I have called the co-operative purpose.

The overall consequence of this is that if indeed there is an imbalance in the domestic political process favouring the protectionist claims of domestic producers, international arrangements sought by producer groups in their own interest may serve as partial rectification. What must be accepted, however, is that efforts to "improve" the international institutional framework must be based on a realistic assessment of the forces actually controlling the outcome. The key is to play upon self-interest to improve the result from the point of view of society as a whole. Doing this requires far greater insight into the relationship between the accomplishment of the ends of the rivals in the political process and the controlling institutional structure than we presently have. All I am able to offer is an extremely tentative set of hypotheses that may shed some light on this vital relationship.

I now turn to two other aspects of the institutional structure governing the regulation of international trade that are, in part at least, explicable by the analysis I have developed.

5. The Division of Institutional Responsibility Within the Domestic Political Process

It is striking in the American institutional structure within which decisions affecting the regulation of international trade are made how the executive, most significantly the President, tends to represent what I have called the co-operative purpose while Congress serves the exploitive purpose.[16] This is, of course, not a generalization without important exceptions. But on the whole, with remarkable consistency, it is the executive that bears the responsibility for making negotiations leading to the reduction of trade barriers as far reaching as possible while the legislature acts as watch-dog to make sure that the executive has not gone too far. Moreover, with respect to domestic legislation granting protection, like the escape clause, the anti-dumping laws, and the countervailing duty laws, substantial reliance has been placed historically on the exercise of executive discretion to mitigate substantially the potential for affording protection contained in these laws.[17] And the deliberative process is filled with assertions by congressmen that the executive has gone too far in granting concessions and has been far too restrained in applying the laws to protect domestic interests. Moreover, when as in the case of the Treasury Department's enforcement of the anti-dumping laws, Congress is apparently dissatisfied with the intensity of enforcement effort, it cannot accomplish its purpose by inducing the President to direct the agency to increase its efforts or by issuing similar directives itself. Instead, it must transfer jurisdiction to another agency, the Commerce Department, which will be more receptive to the notion of intensified enforcement desired by Congress.

The interesting question is whether these different tendencies of Congress and the executive and of various parts of the executive are accidental or rather reflect the basic underlying political reality.

There do appear to be differences in the method of selecting these various public officials and the means by which they seek to influence the outcome that may explain why the exploitive or the co-operative purpose plays a more prominent role in determining their behaviour.

Again, the implicit and explicit log-rolling concepts appear to have some explanatory value.

Both congressmen (including representatives and senators) and the President engage in implicit log-rolling to frame a platform that will command a majority in the constituency that votes for their election. The President's constituency is, however, much wider. If, as is postulated, exploitive legislation benefits a relatively narrow group to a considerable degree, as in the maintenance of high prices for dairy products, the beneficiary class is likely to be geographically concentrated and represent an appreciable portion of the voters in the particular district or state. At the same time, to the extent that the costs of the programme are borne by taxpayers and consumers outside of the district or state, who do not therefore vote for the congressmen or senators, their preferences need not be taken into account in the implicit log-rolling underlying the formulation of a platform. For both of these reasons, the presidential implicit log-rolling is likely to place less importance on the preferences of special interests and more on those of consumers and taxpayers than that of senators or congressmen.

This distinction, however, does not justify a conclusion that the behaviour of Congress as a whole will be more protectionist than that of the executive. Each congressman, after he has done his implicit log-rolling to get elected, must engage in explicit log-rolling with the other members of Congress in order to secure passage of the desired legislation. In another district where no members of the beneficiary group may reside, the representative's implicit log-rolling will lead to opposition to the measure, since the consumer or taxpayer interest, even if not effectively expressed, will control in the absence of any beneficiary group to support the legislation. And in some cases like heating costs in New England, the burden of a programme like the former oil import programme may fall heavily on a particular area. The question then becomes whether the explicit log-rolling among congressmen that thus ensues produces outcomes that, on balance, are more protectionist than the implicit log-rolling by the President, which in principle was affected by the same universe of interests as the explicit log-rolling within Congress. I have no explanation of why one or the other of these processes is more sensitive to the co-operative or exploitive purpose. The basic forces determining the implicit log-rolling by the President and the explicit log-rolling by Congress appear to be identical. The answer then would appear to lie in some systematic difference in the process through which these preferences are taken into account. I cannot, however, identify the characteristics of the processes that would tend to lead to different results across the range of relevant instances. It is, however, interesting to speculate as to what difference, if any, it makes how the political process is structured in various countries to make the requisite implicit or explicit trades. For example, does it matter whether there is a parliamentary system with party discipline so that the power of individual members of the legislature is less? Presumably, in a parliamentary system, the explicit log-rolling that occurs in the United States in Congress instead is conducted within the party structure. Is the overall result different in a parliamentary system than in one like the American arrangement characterized by the diffusion of power among members of the legislature?[18]

There is one respect in which the President's implicit log-rolling is likely to be more responsive to the co-operative purpose and less responsive to the exploitive purpose than the explicit log-rolling of Congress. The President can offer certain "products" that cannot be supplied by any congressman or by Congress as a whole. These derive from his role in conducting foreign affairs. In this capacity he can secure for the country favourable actions from other countries in trade and other matters. If one of the things he must offer in exchange for these is lesser restrictions on imports into the American market, then his implicit log-rolling will include a more favourable position on trade liberalization as a means of securing the benefits resulting from conduct by foreign governments sought by American interests. Admittedly, Congress as a whole, to some degree, has the same opportunities. But the President's pre-eminent role in foreign affairs makes it easier for him than the members of Congress to turn to electoral advantage the value voters place on favourable actions by foreign governments. Thus, the President's implicit log-rolling is likely to lead, on balance, to a less protectionist outcome than the explicit log-rolling within Congress. In simple terms, this is because members of Congress have more difficulty receiving political "credit" for successful international initiatives than does the President.

Of course, the implicit log-rolling by the President and the explicit log-rolling by members of Congress is not the end of the matter. With respect to various issues there is also a form of explicit log-rolling between Congress on the one hand and the President on the other. As one would predict, the outcome over a range of cases is neither as protectionist as would be the case if Congress could act alone nor as free trade oriented as it would be if the President had complete control. And, once again, the explicit log-rolling is not necessarily limited to issues of international trade. Thus, the outcome on any issue cannot be viewed in isolation as if this was the only question under consideration. Every resolution is intimately related to the range of other questions that were included in the relevant vote trading.

The lengthy period preceding the legislation authorizing the Tokyo Round negotiations and the events leading to the passage of the legislation implementing the agreements were characterized by a complex process of bargaining among congressmen and between Congress and the executive. From this process emerged such interesting devices as the congressional veto of various actions the President is authorized to take, the restriction of executive discretion in implementing the anti-dumping laws and the countervailing duty laws, and the transfer of power from the State and Treasury Departments to the Commerce Department.[19] In addition, there has been a protracted struggle between the executive and Congress as to their relative influence in controlling the Office of the Special Representative. All of these events suggest a rivalry and a consequent need for accommodation between the executive and Congress. It also indicates that the executive is not a monolithic body in this regard. The Commerce Department emerges as an agency favoured by Congress. This may be because it has a special constituency of its own whose interests are also served by Congress. In this respect it is different than say the Treasury Department or the State Department, which, like the President, have wider constituencies and a greater degree of involvement in international affairs. Thus the implicit log-rolling engaged in by the Commerce Department, to gain the support of its constituencies, may assign less value to trade liberalization than that assigned by those parts of the executive with wider subject matter jurisdiction and more involvement in international negotiations. Of course, in this regard, there is the initial difficulty of defining the constituency of the Commerce Department. It is obviously dependent on Congress for financial support and the assignment of substantive jurisdiction. But it is also subject to influence by the executive through the appointment process and the intervention of the President and organizations like the Office of Management and Budget, which control the budgetary requests of the department in the process of formulating the overall budget submitted to Congress by the President. The simple point I am making is that whatever process ultimately determines the behaviour of a department like the Commerce Department, it has not traditionally been responsible for international agreements leading to benefits derived from the alteration of the conduct of foreign countries. However, it is necessary to avoid too strong a conclusion on this issue. The Commerce Department has traditionally had the role of promoting American exports in a variety of ways. Conceivably, this perspective will inform its exercise of discretion in enforcing the laws authorizing import restraints. In other words, it may after all include in its own implicit log-rolling the benefits achievable from foreign trade liberalization in deciding how to enforce the anti-dumping and countervailing duty laws. But if this is so, it makes the transfer of jurisdiction from the Treasury Department puzzling. Its apparent purpose was to achieve intensified enforcement. But the analysis makes this explanation questionable.

6. The Form of Intervention into International Trade

The analysis I have developed may shed some light on why restrictions on international trade have come to take the form they have. As indicated above, trade liberalization is explicable on essentially two grounds. First, the political influence of the exploitive purpose may be greater with respect to particular measures than in the case of far-reaching provisions that either directly affect or create an institutional mechanism for dealing with a range of situations. Secondly, lesser accomplishment of the exploitive purpose domestically is traded for the benefits achievable by affecting the domestic political processes of countries constituting important markets.

Both of these explanations proceed from the assumption that it is the concentrated producer group that is in essential control in the domestic political process. This control may be less with respect to general institutional arrangements, but the hypothesis is that important modes of trade liberalization would not emerge if they did not serve the self-interest of producer groups. How then does this hypothesis explain the evolution in the forms that restraint takes?

The first essential point that emerges is that tariffs, which have been substantially reduced by international negotiations, are in one important respect the least advantageous from the point of view of producer interests. This is so because a tariff captures for the government of the importing country the difference between the lower international price and the higher domestic price. If a quantitative restriction is imposed, this value is captured by the person upon whom the right to sell in the domestic market is conferred. This right can be assigned to foreign suppliers, domestic importers, or anyone else whom the government wishes to benefit. Thus quantitative restrictions provide a means of partially compensating groups like foreign suppliers or firms that historically import the good for the losses resulting from the decrease in the quantity of goods that may be imported. Substitution of a quantitative restriction for a tariff is systematically to the advantage of suppliers and importers and would lead to lesser opposition to restrictions in the form of quantitative restrictions than to a tariff of equivalent effect in reducing the level of imports.

Thus part of the "bargain" that may have entered into the international consensus was a transfer to producer groups from governments of the difference between the international and domestic price. This transfer was not necessarily used to purchase their acquiescence in the restriction on their own sales, which in most cases would in balance still be harmful, but rather as additional consideration for reducing their power to secure restrictions in their own countries. Of course, the possibility does exist that a quantitative restriction can actually be beneficial to the suppliers upon whom it is imposed. If the increase in revenue from the rise in price attributable to the restriction exceeds the losses from the reduction in the amount sold, suppliers can realize a net gain. A tariff by capturing for the government what would have been the price increase precludes this effect.[20]

I have more difficulty explaining provisions like the anti-dumping laws, the countervailing duty laws, or more indirect barriers like standards tailored to favour local suppliers. I begin by assuming (as I have argued at length elsewhere) that the traditional efficiency-enhancing rationale for the anti-dumping laws and the countervailing duty laws does not provide an adequate contemporary justification for their existence. Why then do they persist and why are so many resources devoted to the political struggle to determine their precise content?

One, not wholly satisfactory, explanation is that variations in the intensity with which these laws are enforced, and minor changes in their inclusiveness, constitute needed means for making marginal adjustments to reflect changes in the underlying political equilibrium. For example, the trigger price mechanism for enforcing the anti-dumping laws was a device that stood somewhere between the *status quo* and the imposition of quotas or passage of a tariff; these might be more far-reaching responses and would, moreover, be relatively more difficult to reverse. Similarly, variations in the interpretation of the vague "injury" requirements contained in several of the laws affording protection can also reflect changes in the controlling political situation and thus avoid the necessity of legislation that explicitly credits the claims to protection of the affected industry.

What is ultimately puzzling about these laws, however, is why all of the interested parties do not share and act upon an interest in eliminating the waste associated with the political struggle to shape these laws and the administrative effort to enforce them. It is uncertain how much protection these laws really afford, but it does appear that whatever level of protection is generated could be produced in a way that would be materially more beneficial to the persons who stand to gain from the decrease in international competition that results from enforcing these laws. The analysis I have developed may help explain why these laws nevertheless persist.

The protectionist effects of these laws are accomplished in two ways. First, there are the sanctions nominally available under the laws, consisting of anti-dumping or countervailing duties. Secondly, there are the costs of compliance and litigation that may be imposed even on firms ultimately held not to have violated the laws.

The first of these deterrent elements has the same disadvantage as the tariff to the extent that the duties are actually paid. However, since this payment can be avoided by charging a higher price, these operate analogously to a quantitative restriction. Less will be sold because a higher price must be charged, but no part of the price will go to the government. This is systematically more advantageous to foreign producers than a simple tariff that must be paid no matter what price is charged. Thus anti-dumping and countervailing duty laws can, like quantitative restrictions, provide protection to domestic interests at a lesser cost to foreign producers than a tariff providing equivalent protection.

The second aspect of the deterrent effect of these laws is more difficult to explain. If indeed their purposes are fundamentally different than the rationale embodied in the statutory standard, the effort to shape the statutory framework in terms of the purported rationale (i.e., unfair competition or some such) and to determine in enforcement proceedings whether the statute has been violated seems essentially wasteful. And to the extent that beneficiary groups bear the costs of these processes, the net benefits to them of having the laws are thus reduced. Moreover, even if the costs of this type imposed on foreign suppliers serve to deter importation, this effect could be more cheaply purchased by a quantitative restriction that did not require litigation of the host of complex issues involved in the anti-dumping and countervailing duty laws. Indeed, all that is required to provide such relief, without getting into the complexities of the anti-dumping and countervailing duty laws, is a liberal reading of the injury requirement in the relief clause. Why then are all these irrelevant wheels turned? This question is even more puzzling when it is realized that presumably if identical protection could be achieved at lesser cost to foreign interests, then something of value, like less protection abroad, could be "purchased" by agreeing to utilize the devices that do impose lower costs on foreign suppliers.

I do not have a satisfactory answer to this question. All I can think of is that both these laws do, in some degree at least, cause foreign countries to take account of the international consequences of their own import restrictions. One reason why there may be disparity between the home and export price is because the home market is insulated from international competition. Thus the anti-dumping laws impose an additional cost on domestic protection in the form of some impairment of the ability to export. Similarly, the countervailing duty laws reduce the value of subsidization to the extent that it will be nullified by the imposition of a duty upon importation. Arguably, the continued existence of these laws is explicable as one way, albeit imperfect and indirect, of bringing the international consequences of domestic restrictions to bear on the domestic political process. Since this method also confers benefits on producer groups in the country imposing the duty, it is also supported on this ground as well.

All of this, however, is not a very good explanation of laws that are, in my opinion, unjustified,[21] and in any event not very important, if their purported rationale is assumed to be the controlling one; they are far too restricted to satisfy the wider claims to protection of the people invoking them, and they entail substantial costs in shaping and applying the standard of illegality embodied in the law. I do, however, believe that the realization that these laws do resemble quantitative restrictions in their effect on foreign producers does shed some light on their continued existence.

Notes

[1] Richard A. Posner, "The Social Costs of Monopoly and Regulation," *Journal of Political Economy* 83 (August 1975): 807–27; Anne O. Krueger, "Rent Seeking and Protectionism: The Political Economy of the Rent-Seeking Society," *American Economic Review* 64 (June 1974): 291–303.

[2] Klaus Stegemann, "The Efficiency Rationale of Anti-Dumping Policy and Other Measures of Contingency Protection," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[3] See Scherer's examination of the debate concerning efforts by Harberger and others to measure the static welfare losses from monopoly. F.M. Scherer, *Industrial Market Structure and Economic Performance*, 2d ed. (Chicago: Rand McNally, 1980), Chapter 2.

[4] See William Baumol, *Welfare Economics and the Theory of the State*, 2d ed. (Cambridge, Mass.: Harvard University Press, 1967), pp. 221–63; Dennis C. Mueller, *Public Choice* (Cambridge: Cambridge University Press, 1978), pp. 184–207.

[5] It may be necessary to re-emphasize here that the development of operational methods for aggregating individual preferences implicates a wide range of difficult theoretical issues. See Mueller, *op. cit.*, pp. 171–88.

[6] Mancur Olson Jr., *The Logic of Collective Action* (Cambridge, Mass.: Harvard University Press, 1965).

[7] See Richard A. Posner, "Theories of Economic Regulation," *Bell Journal of Economics and Management Science* 5 (Autumn 1974): 335–58; Sam Peltzman, "Toward a More General Theory of Regulation," *Journal of Law and Economics* 19 (August 1976): 211–40.

[8] See Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Row, 1957).

[9] On the mechanics of coalition building in legislatures with few parties, see Jean-Luc Migué, "Trade Barriers, Regulation, and Bureaucratic Supply as Alternative Instruments of Wealth Transfers," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[10] See James Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor: University of Michigan Press, 1962).

[11] James M. Buchanan, "Individual Choice in Voting and the Market," *Journal of Political Economy* 62 (August 1954): 334–43.

[12] For a related analysis of multilateral tariff negotiations, see J.M. Finger, "Trade Liberalization: A Public Choice Perspective," in *Challenges to a Liberal International Economic Order*, edited by Ryan Amacher *et al.* (Washington, D.C.: American Enterprise Institute, 1979), pp. 421–53.

[13] See Gordon Tullock, "Problems of Majority Voting," *Journal of Political Economy* 67 (December 1959): 571–79.

[14] See Robert Hudec, "GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade," *Yale Law Journal* 80 (1971), p. 1310.

[15] See, generally, Anne O. Krueger, *Liberalization Attempts and Consequences* (Cambridge, Mass.: Ballinger for National Bureau of Economic Research, 1978).

[16] See, for example, Robert Baldwin, "Protectionist Pressures in the United States," in *Challenges to a Liberal International Economic Order*, edited by Ryan Amacher *et al.* (Washington, D.C.: American Enterprise Institute, 1979), pp. 223–38.

[17] For a discussion of executive discretion in safeguard actions, see John J. Barceló III, "The Two-Track Subsidies Code — Countervailing Duties and Trade Retaliation," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[18] See, for example, Lester C. Thurow, *The Zero-Sum Society: Distribution and the Possibilities for Economic Change* (New York: Basic Books, 1980).

[19] On the transfer of authority to the Commerce Department, see Reorganization Plan No. 3 of 1979, H.R. Doc. No. 96-193, 96th Cong., 1st Sess. (1979), reprinted in 44 *Federal Register* 69273 (1979). For procedure with respect to congressional bills and resolutions concerning presidential action, see Chapter 5 of the Trade Act of 1974, 88 Stat. 1978, Sections 151–54. As to the lessening of executive discretion with respect to anti-dumping and countervailing duty laws, see Peter P. Ehrenhaft, "What the Antidumping and Countervailing Duty Provisions of the Trade Agreements Act [Can] [Will] [Should] Mean for U.S. Trade Policy," *Law and Policy in International Business* 11(1979): 1361–1404.

[20] For a description of the extra element of waste arising from non-tariff barriers that cause foreign producers to raise their export prices, see Stegemann, *op. cit.*

[21] See Warren F. Schwartz, "An American Response to the Trigger Price Mechanism," *Canada–United States Law Journal* 2 (1979): 77–80.

Trade Barriers, Regulation, and Bureaucratic Supply as Alternative Instruments of Wealth Transfers

5

by
Jean-Luc Migué

As policy instruments, trade barriers are members of a wider species. The species is government interventions in general. My intention is to show that barriers to trade produce the same kind of effects as other forms of government intervention. The level and structure of protectionism should therefore be explained as part of the overall structure of government actions. They cannot be understood in isolation.

One view of government intervention has it that governments intervene whenever markets fail and then to improve their working. Such an evaluation of government intervention has come to elicit laughter in serious economic circles. As we were reminded some years ago by an analyst of regulation,[1] it can be shown that no relationship exists between the extent of government intervention on the one hand, and the presence of external and scale economies on the other.

If the advent and the growth of public interventions are not determined by efficiency requirements, it is doubtful that trade policy is so determined. As the first step toward understanding why trade barriers are set, I shall attempt to determine the kinds of wealth transfers that they give rise to. As a source of cartelization, trade barriers will be shown in the first section to bring about the type of transfers generally associated with regulation proper and with public supply, namely transfers in favour of factor owners. In section 2, other less recognized effects of trade barriers such as cross-subsidization and price or tax discrimination will be shown to follow directly from the general tendency of protectionism to make consumption more uniform. A general result of this view of things will be that similar inter-consumer transfers proceed from standardization inherent in most public-sector interventions besides trade barriers, including direct bureaucratic supply and regulation. Finally, in the last section, I shall attempt to show that this unified view of the effects of government intervention can help in the task of applying economic analysis to explaining nationalistic policies and more generally public-sector interventions so diverse in surface characteristics but actually similar in their effects.

1. Regulation, Bureaucratic Supply, and Protectionism as Sources of Cartelization

In its traditional sense, to regulate is to resort to the coercive power of the state to determine the level of output or price in a given sector. To the analyst, what this action brings about is the weakening of the link that would prevail in an unregulated market between prices and production costs. In competitive and non-monopolistic sectors, the consequences of entry and price regulation have generally been to raise the prices of regulated industries above cost, that is, to non-competitive levels. This is the main inefficiency associated with regulation in the literature. Abundant empirical evidence can be found in support of this proposition, but I shall not go into this here. If such regulatory measures were merely inefficient, they would not have been adopted. But they are adopted because they also result in politically profitable transfers of rent from consumers to suppliers.

The next proposition I wish to develop is that as sources of dissociation of prices from costs, there is no analytical difference between bureaucratic supply on the one hand, and regulation proper discussed above. In most cases of nationalization, a state monopoly is created and competition is reduced relative to what it was prior to the shift to public supply. With a given budget, government supplies a lower level of output than would be produced under a market system.[2] In a fashion similar to regulation, public production generates opportunities for rent transfers in favour of factor suppliers and of whatever subgroups carry the day in the political market.

That tariffs and quotas act as sources of higher prices and lower competition in protected sectors is a basic proposition of conventional analysis. This is clearly the main but by no means the only burden associated with tariffs and quotas in classical analysis. The partial elimination of foreign competitors leads domestic suppliers to increase their share of the home market. Such a substitution is accompanied by higher production costs, which in turn result in higher prices to buyers. Thus a first result of looking at barriers to trade as sources of cartelization and higher prices is to show that protectionism does not differ in its effects from shifts to government supply and from other varieties of sectoral regulation discussed above.

Specific Factor Owners as Beneficiaries of Barriers to Trade

In the literature on international trade, protectionism is viewed as a source of wealth transfers in favour of production factors in protected industries. More specifically, tariffs and quotas act as subsidies from buyers to factors of production in protected domestic industries. Similarly, government subsidies to domestic sectors, whether in the form of direct grants, procurement rules, or outright nationalization of inefficient firms, all obviously cause transfers from taxpayers to factors of production in subsidized industries. Resort to any form of protectionism is equivalent, for the industries concerned, to upward shifts in demand.

This in no way means that all factor owners in those industries and elsewhere benefit equally from such rises in domestic demand. The classical view on the sharing of benefits and costs from barriers to trade is that factors that are scarce in the country levying barriers relative to the endowments of trading partners will receive higher real incomes, while the other factors will experience a drop in real income.[3] This is a long-run result, which obtains after resources have been reallocated on the basis of post-barrier supply and demand conditions.

On the other hand, it can be argued that analytically relevant transfers do not occur only as a result of changes in relative earnings once all adjustments have been completed and a new equilibrium has been attained. Income gains or losses can also be anticipated by some factor owners during the transition period from the pre-barrier equilibrium to the new post-barrier equilibrium, during which the equalization of returns to factors is not yet fully realized. The length of the transition period varies greatly with the nature of the factors considered, that is, with their elasticity of supply. As a general rule, the period is chronologically short for less-qualified manpower and for capital, whereas it could take several years to move toward a new long-term equilibrium for professional and managerial manpower. It is this difference in the length of the transition period that explains why the expected benefits from increased protectionism are generally greater for professionals and managers than for the owners of other factors of production.[4]

The foregoing discussion suggests that the benefits of protectionism vary proportionately to the level of training, education, and specialization of manpower in protected industries. Groups of non-professional and non-managerial workers can also take action to gain benefits from protectionism. An obvious example is restrictive labour policies, which reduce the speed and facility with which labour supply responds to an expansion in demand. Also, in declining industries, plant and equipment can hardly be liquidated more quickly than depreciation permits. Specificity of the labour force's training and experience also makes it difficult and costly to transfer workers in declining sectors to other types of activity. In these circumstances, when supply cannot easily adjust downward, additional protection against foreign competition can stop, or slow down, the decline.

Two points have been established. First, it was shown that the analysis of protectionism does not differ from that of public supply and government regulation. In all three cases, cartelization generates transfers that go not from foreigners to nationals but from the citizens of the protectionist country to limited groups of producers in the same country. Secondly, losses from barriers to trade are widely dispersed throughout the population of consumers and taxpayers, whereas the gain is concentrated among professionals and managerial personnel in protected industries. The best-organized union members, as well as capital owners and workers in declining industries, often receive gains from these protectionist measures. In all cases, the benefits are more concentrated than the costs.

2. Government as an Instrument of Cross-Subsidization and Price Discrimination

In addition to their role as instruments of cartelization, regulation proper, public supply, and barriers to international trade also influence the price structure within affected sectors. Consumers are thus differentially affected by changes in the price-cost relationship resulting from these various practices. Considering regulatory action first, two broad types of differential treatment of consumers can be defined. First, regulation can introduce, maintain, and possibly attenuate price variations on the basis of differences in levels and elasticities of demand between consumers. Economics has a word for this: it is called price discrimination. It is practised whenever consumers with high and/or inelastic demand are charged higher prices than consumers with low and/or elastic demand. This phenomenon is widespread in regulated industries, including transportation, licensed occupations, electricity, securities exchange, telephone, natural gas distribution, and so forth.

Price discrimination is traditionally viewed as a mechanism for raising profits, that is, for transferring rents from consumers to producers. But there is no a priori reason why it cannot occasionally benefit other subgroups of consumers, as occurs when the value extracted from some serves to carry out cross-subsidization. The effects of this latter practice on the price structure differ from price discrimination in being based on differences in cost conditions between consumers rather than in demand conditions. Regulated firms practise cross-subsidization whenever they charge high-cost consumers below-cost prices. Losses incurred in supplying such preferred customers are made up by profits derived from charging prices higher than cost to low-cost consumers. For instance, the automobile insurance rate structures designed by regulatory agencies often entail elements of subsidy from drivers in general to high-risk (high-cost) drivers.

This way of looking at regulation underlines the fact that regulation makes consumption more uniform between consumers. Consumption by various consumers is standardized both in quantity and in quality. This is the case first because differences in demand are reflected more in price discrimination and less in the amount consumed relative to what would occur in an unregulated market. This is also the case because differences in the cost of serving various consumers are reflected less in price differences relative to what would obtain in an unregulated market, and more in cross-subsidization in favour of high-cost demanders.

How about the allocation of output between consumers in a public supply system where price rationing is generally abolished? Clearly some alternative rationing device has to reveal that resources are scarce. This mechanism is standardization, that is, the availability to most consumers of a uniform quantity and quality of goods, no matter what the preferences and costs of various consumers are. It is my belief that economic analysts of politics have not sufficiently emphasized this almost universally observed consequence of public supply. Nationalization and standardization almost always go hand in hand. Consumption varies less in quantity and quality between consumers in a bureaucratic production system than in a market system, where quantities and qualities are allocated on the basis of demand and cost conditions.

Now what is the analytical meaning of standardization in bureaucratic production? The tendency toward more uniform consumption inherent in bureaucratic production is the exact counterpart of the cross-subsidization and price discrimination practices associated above with regulation proper. First, within a given tax structure, a greater uniformity of consumption is clearly equivalent to high-cost consumers-taxpayers being subsidized by low-cost consumers-taxpayers. To make consumption more uniform between consumers in different cost conditions within a given tax structure is equivalent to making prices more uniform by direct regulation. For instance, to standardize the quantity and quality of education through bureaucratic production is to subsidize high-cost, rural, and less gifted students by charging high tax prices to low-cost, urban, and more talented students.

Similarly, what is the analytical significance of output standardization between two individuals with varying demands? As long as the entire consumers' surplus is not exhausted, standardization means that the marginal benefit derived by an individual with a high demand is greater than the marginal benefit of an individual with a low demand. Even when pushed beyond its optimal level, an evenly shared amount of public output may appear inadequate to people with high and/or inelastic demand. This is because as high demanders they received the highest consumers' surplus. They are the subgroup from which the bureaucratic monopoly will find it easiest to extract value. Higher budgets are thus obtained by political and bureaucratic entrepreneurs, the product of which they can appropriate for themselves or allocate to factor suppliers and other groups of consumers-taxpayers (through cross-subsidies).

What we believe has been accomplished by the presentation above is that we are able to generalize a thesis that one author reserved to the educational sector only.[5] In Thomas Borcherding's view, the tendency toward uniform school services between blacks and whites in the U.S. South can be viewed as a form of tie-in sale, whereby white taxpayers with a high demand are forced to offer the same level of output to black taxpayers with a lower demand. As I have tried to show above, there is no reason why this result should be limited to education only and to demand variations associated with races.

3. Protectionism as a Source of Changes in the Price Structure

My purpose in assessing the impact of these various government interventions was to emphasize that protectionism, regulation, and public supply have more in common than just raising prices to consumers by reducing competition or raising taxes to general taxpayers for the benefit of some factor owners. Subgroups of consumers stand to gain at the expense of others from any one of the direct and indirect aids to specific sectors associated with both tariff and non-tariff barriers to trade.

Let us first consider the possible influence of tariffs and quotas on the price structure. The basic teaching of economics is of course that such policies victimize all consumers. But in non-homogeneous-product sectors, they can clearly result in raising some prices and reducing others. If that should occur, we would be facing an obvious instance of cross-subsidization. This is likely to be the case whenever tariff barriers raise prices to consumers with preferences for foreign goods while reducing prices to consumers with preferences for domestic goods. The idea that tariffs and quotas entail cross-subsidization is thus particularly valid in industries with pronounced scale economies, like publishing, radio, television, and industries with high linguistic content. In such decreasing-cost industries, enlarging the share of the local market served by domestic suppliers may result in lower prices to consumers of domestic substitutes. The reasoning behind this conclusion is similar to the infant industry argument traditionally used as a basis for proposing protectionist policies for sectors in early stages of development.

Let us consider a few specific cases of inter-consumer transfers resulting from tariffs and quotas in decreasing-cost industries. Canadian viewers with preferences for foreign programmes are the prime victims of quotas and implicit tariffs set on radio and television channels and programmes. Such constraints restrict their freedom to choose the programmes they wish to watch. On the other hand, it hardly needs to be recalled that radio and television broadcasting enjoys almost unlimited scale economies: one more listener adds practically nothing to production costs, so marginal cost is, in effect, zero. In the end, consumers with preferences for non-Canadian programmes are prevented from benefiting from the large-scale economies of foreign producers. At the same time, the number and variety of Canadian productions increase, and this means lower production costs and a greater variety of Canadian programmes, a clear case of wealth transfer from low-cost to high-cost consumers.

Readers in Canada pay for the implicit tariffs levied on foreign magazines and newspapers through discriminatory tax treatment of foreign publications. No Canadian producer can compete with large international magazines in terms of production costs because of the limited size of the market. However, the fact remains that the publication of a magazine destined for the Canadian market realizes a cost reduction as a result of the widening of the readership. High-cost readers with a preference for domestic substitutes thus receive a net transfer of wealth from other Canadian readers with different preferences.

Numerous government measures designed to promote scientific and technological sovereignty act as implicit tariffs and quotas on foreign know-how and technology and, as such, result in the partial substitution of domestic for "foreign" science and technology. These measures include restrictions on foreign ownership of a type with which Canadians are familiar, such as the outright exclusion of foreign investors from certain sectors, the screening of foreign investment, and others. The production of knowledge and technology is a decreasing-cost industry. This explains why multinational firms enjoy an undisputed advantage with respect to technological innovation and the diffusion of technology. Their size and market scope enable them to spread the large fixed costs of investment in research and development over a more optimal volume of output. Access to a world market makes it possible for the firm to adopt best-practice technologies, that is, those that minimize costs. Finally, a multinational firm is in a position to minimize the transmission costs of distributing technological know-how throughout its domestic subsidiaries.

One consequence of this kind of protectionism is that domestic buyers or users of the capital, the technology, and the know-how associated with these international activities suffer losses from being deprived of these opportunities. Complementary labour earns lower wages while consumers pay more for goods and services produced with foreign capital and technology. But, by the same reasoning, buyers of domestic capital, technology, and know-how derive a net benefit from the economies of larger scale made possible by the production of domestic knowledge and innovations.

Another subgroup of consumers likely to gain from protectionist measures in Quebec are consumers of goods and services having a high French-language content. Quebec's language policy acts as a tariff on non-French goods and factors. It can serve to protect local producers of goods with a high linguistic content against competition from substitute goods and services coming from outside the linguistic community. In other words, the francization policy (wider use of French in schools and business as well as in advertising and labelling) can generate growth in local demand for consumer goods and services having a high linguistic content. Since the industries concerned generally offer opportunities for realizing scale economies, consumers with preferences for the output of French artistic and cultural industries (books, schools, radio and television, publishing, cinema), of French scientific and research activities (college and university teaching), and of French information industries (newspapers, magazines, and periodicals) stand to gain from any expansion of the market for their preferred goods. Thus certain consumers are being subsidized by others in an obvious application of the cross-subsidization rule.

In contrast with tariffs and quotas, which in orthodox analysis victimize consumers and workers, the costs of discriminatory subsidy policies, be they implicit — preferential procurement and nationalization policies, or direct — subsidies to buyers of local factors, are borne by taxpayers in general and the benefits go primarily to owners of factors in inelastic supply. Our point here is that nationalistic subsidies can affect the price structure in non-homogeneous-product sectors in ways favourable to subgroups of consumers with tastes for Canadian substitutes. For instance, the policy of subsidizing Canadian books possibly transfers wealth not only to Canadian authors and managers of publishing houses but presumably to readers of Canadian substitutes for foreign books. By giving preference to domestic research and technology through various grants, Canadian science policies result in transfers of wealth from taxpayers not only to scientists but presumably to buyers of Canadian substitutes for foreign technology and know-how. The same can be said when governments commit themselves to unprofitable nationalization endeavours and costly purchasing practices, in order to transfer wealth not only to domestic professionals and managers but also to consumers who derive satisfaction from acquiring Canadian-made substitutes.

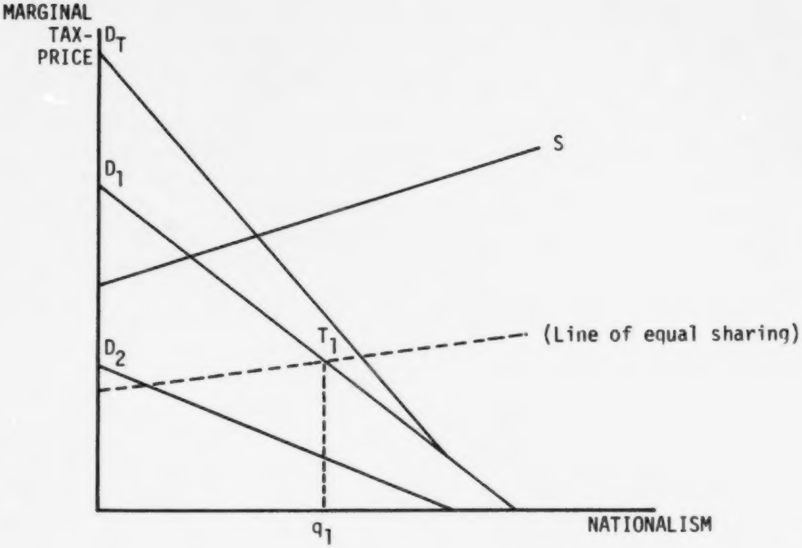
That various tariff and non-tariff barriers to trade entail cross-subsidization in favour of consumers with preferences for domestic goods is therefore supported by numerous instances of protective policies in Canada. The above discussion was not presented as a systematic organization of empirical evidence, which clearly would be desirable. What the above argument tends to demonstrate nonetheless is that standardization of consumption is central to both trade policies and the other major forms of state intervention in markets, such as regulation and public supply. Indeed it should strike students of international trade that one general consequence of protectionism is to narrow consumers' choices by restricting access to lower-cost foreign goods and services and enlarging the market for high-cost domestic goods and services. As in other varieties of cross-subsidization, subsidies go from demanders of low-cost foreign goods to demanders of high-cost domestic goods in conditions where scale economies are present.

While cases of cross-subsidization associated with trade barriers are easy to document, it would seem at first sight that price discrimination can in no way be shown to be a general result of protectionist policies. Yet in a very real sense, price and tax discrimination are often a direct consequence of trade policies. To show that this is the case, one needs only to argue that for an undetermined number of citizens, nationalism is a public good. Some people derive pleasure not only from their own consumption of domestically produced goods and services, but also from other people consuming such goods and services. In fact, in journalistic and political language, this is what nationalism often seems to designate. A non-negligible number of Canadians appear to be willing to pay a price for having domestic television networks and a domestic automobile industry, even as they tune in U.S. networks most of the time or drive a Toyota. Therefore what these people are demanding is a collective good.

Let us therefore assume that there is a normal distribution of demands for nationalism over the population. Clearly people differ in the level and the elasticity of their demand for such a publicly produced good. Now such variations in preferences open up vast opportunities for discriminatory practices by the public monopoly supplier. Figure 1 below illustrates how different intensities of nationalism can be formalized. The demand for nationalism is represented by D_T, which is the willingness of people to bear a cost to have an expanded domestic set of industries. Individuals like 1 are the nationalists, as opposed to individuals like 2, who are the non-nationalists. The supply of nationalism S is the cost to domestic consumers-citizens of having to pay higher prices and/or taxes for foreign goods and their domestic substitutes.

It is not my purpose to develop a theory of the tariff structure, let alone of the tax structure, based entirely on the existence of a demand for nationalism. What needs to be emphasized here is that more political support for nationalistic protectionist policies can be gained by resort to price and tax discrimination. For instance, a tariff or subsidy barrier to trade, equivalent to q_1T_1 in Figure 1, which would imply equal sharing by both individuals 1 and 2, could not possibly gain the support of non-nationalists, like 2, for any level of protec-

Figure 1



tionism. On the other hand, at all levels of nationalistic output below q_1, the marginal benefit of trade barriers to nationalists, such as 1, is higher than their marginal cost, when shared equally. Therefore, assuming that suppliers of nationalism, that is, politicians and bureaucrats, can benefit more from a higher than a lower level of publicly supplied output, they will find it in their interest to discriminate. Whether the supplier's gain takes the form of higher budgets, higher discretionary power, or otherwise, more of the consumers' value can be extracted if higher taxes are levied on nationalists than on other people. The final outcome depends on the rules governing political and bureaucratic processes.

From our point of view this is a striking result. Once again we find ourselves facing the now familiar result of discrimination and cross-subsidization through standardization, inherent in trade policies. Implicit subsidies are paid by consumers whose preferences are for low-cost foreign goods to consumers whose preferences are for high-cost domestic substitutes. Alternately, nationalists are the subgroup most likely to support protectionist policies; the instrument resorted to by the public supplier of nationalism to extract value from them is tax discrimination. Trade policy is another way for public intervention to suppress or attenuate distinctions based on differences in demand and cost conditions between consumers.

4. Trade Barriers as a Mechanism for Rent Transfers

The primary purpose of this evaluation of the effects of various government interventions is to lay the basis for an economic theory of government in general, and of protectionist policies in particular. I shall argue that the unified view of government interventions presented above can be shown to be consistent with a single model of imperfect competition in the bureaucratic and political market.

I shall retain most elements of what can be viewed as the accepted framework for the economic analysis of representative government. On the other hand, I shall emphasize the role of competition between political parties more than is usually the case in the standard analysis of governments. In that perspective, the political market can be regarded as a mechanism resorted to by people for the purpose of transferring rent or wealth in their favour. What is exchanged in this market is transfer policies for votes. Suppliers of policies, that is, the production agents, are the political entrepreneurs together with the firms that they run, the political parties. Demanders of transfers are the citizens, who offer or withdraw their votes in return for the rent transfers they derive or lose.

If this political market was perfect, that is, if competition between politicians was strong, no political entrepreneurs could gain votes by offering policies that did not generate welfare gains. The real world is different. To engage with some chance of success in the exchange of votes for transfer policies, citizens must make use of numerous instruments of political action, including lobbying, efforts to acquire information for voting purposes, migration between jurisdictions, membership in social movements, and so on.[6] Because no one can avoid incurring various proportions of these costs in seeking rent transfers, competition between politicians in the vote market is imperfect.

An important consequence of this state of affairs is that individuals will invest in political activities only until returns are equalized at the margin with those generally available in the economy. This is the simple extension to politics of accepted price theory. And because citizens expect differential benefits and costs from the various bundles of policies offered them, the amount invested by each individual or group of individuals will vary. From the politicians' point of view, this means that political entrepreneurs, in their desire to gain votes and secure their election, will supply policies that offer concentrated benefits to some organized groups and they will distribute the burden widely to other groups. This process will be carried out to the point where policy bundles offered tend to equalize marginal vote gains with marginal vote losses.[7] This condition implies that political entrepreneurs diversify their support.

5. Trade Barriers Demanded by Factor Suppliers

What are the policies most likely to confer concentrated benefits on the few and small losses on the many? In terms of our discussion in previous sections, an important consequence of this logic is that producers will invest more than consumers in political action. Policies will be biased in their favour. The tendency to cartelize competitive sectors through direct regulation, nationalization, or protectionism should be more pronounced than the tendency to contain prices in naturally monopolistic sectors. This prediction clearly agrees with the known empirical results. The capture theory of regulation may be an extremist position, but it remains more maintainable than the traditional and popular notion that the government's goal is to further the common good and protect the consumers against suppliers' abuses.

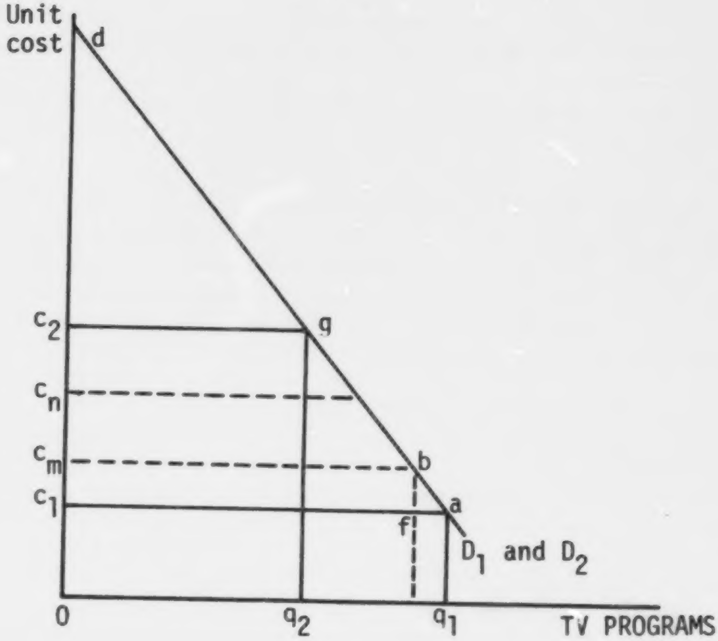
As sources of cartelization, barriers to trade result in transfers similar to those associated with regulation and bureaucratic supply. Protectionist policies act as instruments to expand the demand for domestic products. Tariff and quota policies victimize consumers and workers, whereas taxpayers bear the cost of preferential procurement policies and subsidies to domestic producers. In other words, while the loss is widely dispersed throughout the population, the gain is concentrated on factor owners whose supply is less elastic. Such is the case for professionals and managers whose supply can be increased only after a long and costly accumulation of human capital. This conclusion also applies to the best organized union members, whose supply inelasticity is rooted in institutional conditions, as well as to production factors in depressed industries where transfer of resources to other activities is costly and difficult.

6. Concentrating the Benefits of Trade Barriers on High-Cost Consumers

By the same reasoning there is also room in the political market for the promotion of the interests of subgroups of consumers at the expense of other consumers' interests. In other words, the political power function is not reflected exclusively in the domination of producers over consumers. In effecting changes in the price structure through trade barriers, political entrepreneurs find themselves concentrating benefits on high-cost consumers while spreading the burden more widely on low-cost consumers.

Consider the relative position of, say, a television viewer with a strong preference for U.S. shows and a viewer having a preference for Canadian productions as illustrated by Figure 2. They are differentiated by the level of their respective unit costs, Oc_1 and Oc_2. By virtue of his unit cost being lower, the consumer with a preference for foreign programmes obtains a higher consumer's rent than his neighbour in

Figure 2



an unprotected television market. This opens up opportunities for politicians to gain votes by concentrating benefits on high-cost viewers and diffusing the burden on low-cost viewers. Consider a hypothetical rise of c_1c_m in the unit price of foreign television programmes as a result of our quota and implicit tariff system on radio and televison. This represents a relative loss of $\left[\frac{c_m bac_1}{c_1 da} \text{ .100 per cent}\right]$ in consumer 1's surplus. Now suppose that part of the product of such a tax ($c_m bfc_1$) is indirectly transferred to the other viewer in lower prices (c_2c_n), as a consequence of scale economies in Canadian productions. While it could easily be shown more rigorously, a simple look at Figure 2 should convince the reader that the *relative* surplus loss of 1 is lower than the *relative* surplus gain $\left[\frac{c_m bfc_1}{c_2 dg} \text{ .100 per cent}\right]$ to individual 2. The relative loss of the viewer of foreign programmes can be shown to be lower than the relative gain of the viewer of Canadian programmes. Thus in effecting changes in the price structure in favour of high-cost consumers, political entrepreneurs find themselves concentrating benefits on some consumers while spreading the burden more widely on others. The political process also does that through its other instruments of output standardization. In sectoral regulation, standardization is accomplished through direct reductions in the price spread between low-cost and high-cost consumers. When bureaucratic supply is resorted to, standardization is imposed by decree, queueing and other non-price rationing techniques, including random allocation by chance.

7. Levying Taxes on Nationalists

Finally, as shown earlier, standardization can also include elements of price or tax discrimination against consumers with high or inelastic demands. Because of the high consumers' surplus of individuals with high demands, standardization by government suppliers is equivalent to price discrimination or tied sale. It gives rise to a wealth effect that makes it possible for politicians to extract a higher value from high demanders for possible transfers to factor owners and/or to low demanders through cross-subsidies. Because of these different conditions of demand, the relative loss of the former can be lower than the relative gain of the latter. More voter support is gained by public suppliers or less opposition is elicited. When applied to protectionist policies, this means that nationalists are prepared to pay a price for expanding domestic industries. As high demanders of nationalism, their opposition to higher prices or taxes in protected sectors is likely to be weaker. Tax discrimination can even bring them to join factor owners in coalitions for higher trade barriers.

Conclusion

The main proposition developed in this essay can be summarized as follows: when the analytical significance of their effects is fully worked out, one finds that all public-sector interventions generate similar results. Thus trade barriers give rise to a tendency toward reduced competition, for the benefit of specific factor owners, but so do all other main forms of government intervention including regulation and bureaucratic supply. Likewise protectionism results in standardization or more uniform consumption by restricting access to low-cost foreign goods and services. But standardization is also a direct consequence of regulation and public supply.

Standardization in turn is just another name for changes in the unregulated price structure. It first entails cross-subsidies from low-cost consumers to high-cost consumers, as is the case when trade barriers impose a tax on low-cost imports to expand the market for domestic substitutes in decreasing cost industries. But output standardization also means price or tax discrimination against consumers with high or inelastic demand. As high demanders of a public good called nationalism, nationalists are more easily brought into coalitions favourable to protectionist measures, of which they have to bear the burden in higher prices and taxes. Again, similar results follow when uniform school services are offered over a given territory by bureaucratic suppliers. Through this kind of tied sale, taxpayers with a high demand are forced to share the same level of output with taxpayers having a low demand. In effecting such changes in the price structure at the expense of high-demand and low-cost consumers in favour of high-cost consumers, political entrepreneurs find themselves concentrating benefits on some consumers while spreading the burden more widely on others. These general results are consistent with a single model of imperfect competition in the political and bureaucratic processes. In particular, the discussion suggests that there is no theory of protectionism different from the theory of representative government.

Notes

[1] Richard A. Posner, "Theories of Economic Regulation," *Bell Journal of Economics and Management Science* 5 (Autumn 1974): 335–58.

[2] This should not be taken to mean that bureaucratic production generally undersupplies. Given the vast opportunities for discrimination offered to politicians and bureaucrats in a non-competitive environment, excess budget and output and production inefficiencies by the same agency are both predicted in most versions of the economic theory of government.

[3] This thesis was originally developed by Wolfgang F. Stolper and Paul A. Samuelson, "Protection and Real Wages," *Review of Economic Studies* 9 (November 1941): 58–73. For an application of this view to Canadian conditions, see Don J. Daly and Steven Globerman, *Tariff and Science Policies: Applications of a Model of Nationalism* (Toronto: University of Toronto Press for Ontario Economic Council, 1976).

[4] This opinion is more fully developed in Jean-Luc Migué, *Nationalistic Policies in Canada: An Economic Approach* (Montreal: C.D. Howe Research Institute, 1979).

[5] Thomas E. Borcherding, "An Economic Approach to School Integration: Public Choice With Tie-Ins," *Public Choice* 31 (Fall 1977): 53–77.

[6] For a further description of those costs, see Albert Breton, *The Economic Theory of Representative Government* (Chicago: Aldine-Atherton, 1974).

[7] A rigorous formulation of this process can be found in Sam Peltzman, "Toward a More General Theory of Regulation," *Journal of Law and Economics* 19 (August 1976): 211–40. The idea was also set forth in Jean-Luc Migué, "Controls Versus Subsidies in the Economic Theory of Regulation," *Journal of Law and Economics* 20 (April 1977): 213–21.

Part Three

International Regulation of Domestic Commercial Policy

The Two-Track Subsidies Code — Countervailing Duties and Trade Retaliation

6

by
John J. Barceló III*

1. Introduction

The Tokyo Round Code on Subsidies and Countervailing Duties[1] provides two tracks for controlling the trade effects of government subsidies. Under Track I, a country may levy traditional countervailing duties to offset foreign subsidies on imported goods.[2] Under Track II, a country may file a complaint with the code's Committee of Signatories seeking modification of a foreign subsidy or a right to retaliate against its adverse effects.[3]

This essay argues that Track I is not a progressive step toward a more efficient, equitable, and open trading order. It argues that a regime of countervailing duties cannot be squared with the efficiency and equity reasons underlying most of the GATT[4] rules and principles. Track II, by contrast, is a promising way of dealing with the genuine issues raised by subsidies, mostly those concerning displacement of *exports*. For the problem of disruptive *imports*, the essay argues that a liberal trading country needs essentially only a single safeguard law that does not ask why imports are low priced. Disruptive imports are only a problem because they are disruptive, not because a subsidy (instead of an innovation) has increased their volume. From that standpoint, the failure of the Tokyo Round to produce a Safeguards Code[5] is lamentable. If that deficiency is corrected in the future, the GATT countries may be more willing to eliminate countervailing duty laws altogether.[6]

Section 2 will give an overview of the Subsidies Code. Section 3, the bulk of the essay, will analyse Track I of the code (countervailing duties) and the rationale (or lack of one) for this remedy, especially by contrast with the rationale for safeguard relief. Section 4 will analyse Track II and the rationale for the trade retaliation provisions.

The essay emphasizes the domestic law of the United States as an example of how the GATT rules are incorporated into national law. This is because the U.S. law is likely to serve as a model for other countries,[7] and because this writer is more familiar with it.

2. An Overview of the Code

For convenience, at various points, we will assume that a hypothetical country, Utopia, grants a subsidy and then we will analyse its effects on the United States. A subsidy in Utopia that increases Utopia's production of widgets can have two basic effects on American trade. It can (1) increase imports of widgets into the United States and (2) decrease exports of American widgets. The latter effect can have two components: reduced American exports to Utopia and reduced American exports to third countries (supplied instead by Utopia goods). Track I countervailing duties block the first effect, an increase in imports. Track II retaliation is the only remedy for loss of exports, but it may also apply to bounty-fed imports. In the latter case, the two tracks overlap and are both available as remedies, although not in tandem.

The code's bifurcated approach to subsidies came about because of pressure from other countries to have the United States add an injury requirement to its countervailing duty law. The United States countered with a demand that other governments agree to restrain their use of subsidies.[8] Prior to the code, the American law imposed countervailing duties on subsidized imports, otherwise dutiable, regardless of whether such imports were injuring an American industry.[9] The Trade Agreements Act of 1979 implementing the code added a "material injury" requirement.

Track II became the quid pro quo for this U.S. concession. It limits a signatory's freedom to subsidize by (1) expressly prohibiting *export subsidies* on manufactured and mineral products,[10] (2) imposing quasi-restrictions on the use of *domestic subsidies*,[11] and (3) providing a special complaint procedure for government-to-government disputes under provisions (1) and (2).[12]

The distinction just noted between domestic and export subsidies is important and should be clarified. In this essay and in the code, a *domestic subsidy* is one granted without regard to product destination. Hence, Utopian subsidies for research and development, to encourage investment in depressed regions or to assist ailing industries, would generally be domestic subsidies.[13] Market forces would determine what proportion of the subsidy-induced extra output stayed home and what proportion left the country. An *export subsidy* is one granted only on that portion of output exported. Utopian grants restricted to exporters, interest rate subsidies for financing exports, or rebates of income taxes tied to the proportion of output exported would all be export subsidies.[14]

The code treats export subsidies more harshly than domestic subsidies.[15] For reasons explained later, that distinction seems sound under Track II but not under Track I, largely because it is difficult to justify Track I relief against any subsidy.

Were one to accept the wisdom of a Track I countervailing duty regime in the first place, the code might be seen to add important protections against arbitrary, especially protectionist, applications of such laws. The code requires notification and open procedures,[16] it encourages negotiated settlements,[17] it requires "material injury,"[18] and it provides a procedure (that found in Track II) for multilateral review of countervailing duty decisions challenged by an affected signatory.[19] In an imperfect world, perhaps these achievements should be celebrated, but that is not the goal of this essay. This essay stresses that countervailing duty laws themselves are protectionist, no matter how impartially applied. They provide protection not available under the general safeguard law. Yet there seems no principled reason why an importing country should, in general, treat subsidized imports more harshly than those not subsidized. Thus the essay urges the need for further simplification and improvement of the trade system through elimination of countervailing duty laws. For protection against injurious imports, it argues that each GATT country should rely instead upon its general safeguard law.

The next section will develop this point in three steps. First, it examines the ways in which a countervailing duty law is more hostile to subsidized imports than is a safeguard law to imports generally. To add concreteness we will focus the comparison on the U.S. countervailing duty and safeguard laws. The U.S. safeguard law is found in the escape clause and adjustment assistance provisions of the Trade Act of 1974.[20] Secondly, it explores the rationale (within a liberal trade system) for import restrictions under a safeguard law. Finally, it explores the inadequacy of efficiency and equity arguments for harsher reaction to subsidized imports.

3. Track I — Countervailing Duty Laws

A. Countervailing Duty and Escape Clause Relief Compared

Among the many differences between countervailing duty and escape clause relief under the applicable U.S. statutes, three stand out. First, the injury standard prerequisite to relief is higher in an escape clause case. Secondly, relief is discretionary under the escape clause but mandatory (and adjudicatory) under the countervailing duty laws. Thirdly, relief is temporary under the escape clause but largely permanent under the countervailing law. A brief elaboration of these points follows.

For escape clause relief against disruptive imports, a domestic producer or labour representative first files a complaint, and then the International Trade Commission (ITC) must decide whether increased imports have been a "*substantial cause*" of "*serious injury*" to the domestic industry.[21] If the decision is positive, the ITC recommends to the President the degree and form of trade restriction needed to remedy the injury. Finally, the President, at his discretion, must decide whether to adopt (1) the trade restriction recommended; (2) a different kind or degree of restriction; (3) adjustment assistance (various forms of financial and technical assistance to firms and workers);[22] or (4) no remedy.[23] An important provision of Article XIX of the GATT on safeguard relief partly explains why Congress gave the President such wide-ranging discretion. A country invoking that article to withdraw a tariff concession normally must offer compensating tariff concessions to countries whose trade interests are adversely affected. If an affected country is still unsatisfied, it has an automatic right under Article XIX to retaliate against the invoking country.[24] Hence, the executive will generally seek a compromise before invoking relief.

For countervailing duty relief under the new 1979 law, a domestic producer or labour representative again files a complaint, this time with both the Commerce Department and the ITC.[25] Commerce decides whether imports are subsidized,[26] and the ITC decides whether a domestic industry is "materially injured . . . by reason of" subsidized imports.[27] If Commerce and the ITC answer these questions affirmatively, customs officers must levy on all offending imports countervailing duties equal to the *ad valorem* amount of the subsidy.[28] The President has no discretion to avoid relief. Under the GATT and the Subsidies Code, the subsidizing government has no right of retaliation.[29]

The Injury Standard

Less injury to a domestic industry is required for countervailing duty relief than for an escape clause remedy. The difference cannot be stated, however, in precise amounts of import penetration, falling profits, percentage of unemployment, and so on. Two parts of the injury test are relevant: the necessary quantum of injury and the required degree of causal nexus between that injury and imports. The statutory standards under the escape clause are "serious injury" and "substantial cause." The statute defines the latter concept as a cause that is both important and not of lesser significance than any other cause.[30] Under the countervailing duty law, by contrast, the standards are merely "material injury" and "by reason of [subsidized imports]."[31] The statute confirms the impression of weakness in this quantum of injury language by defining "material injury" as "harm which is not inconsequential, immaterial, or unimportant."[32] Both the Senate and House reports explain that the "material injury" standard should coincide with the test the ITC used in anti-dumping cases after the Trade Act of 1974.[33] These decisions applied, at best, only a slightly stronger version of the extremely weak *de minimis* injury standard that dominated anti-dumping cases in the late 1960s and early 1970s.[34] Most commentators concur that the anti-dumping test has been and remains distinctly weaker than that applied under the escape clause.[35]

The Senate and House reports state even more explicitly that Congress intended the "by reason of" causation standard of the countervailing duty law to be less demanding than the "substantial cause" test under the escape clause.[36] Under the escape clause, imports must contribute to any observed industry difficulties to at least as great an extent as any other cause, but no such comparison or relative weighing is necessary under the countervailing duty law.[37] The upshot is that the level of injury and causation needed for a prima facie case is lower under the countervailing duty law than under the escape clause. For convenience, the analysis below will refer to the escape clause standard as *first-level injury* and the countervailing duty standard as *second-level injury*.

This difference in injury standards is not an aberrational feature of U.S. implementation of GATT principles. The GATT in its safeguard provisions in Article XIX requires "serious injury." In Article VI on countervailing duties and in Track I of the new Subsidies Code, on the other hand, the standard is "material injury." Although this writer had found no reference to this difference in language in the legislative history of the original GATT, the possible significance of the difference could not have been lost on the code signatories. The inclusion of an injury test in the U.S. law was one of the main goals of most of the signatories, and both the Senate Finance Committee and the chairman of the U.S. International Trade Commission had said, in a related context, that "material injury" represents a lesser degree of injury than "serious injury."[38]

Discretionary versus Adjudicatory Procedure

Under the escape clause, after the ITC finds injury and recommends relief, the President has discretion to refuse relief altogether or, in effect, to substitute adjustment assistance (subsidies) to firms and workers in place of trade restrictions. The statute requires that the President's decision focus on such factors as the effect of trade restrictions on consumers and on competition in the domestic industry; the economic and social costs to taxpayers, communities, and workers of imposing trade restrictions and of failing to do so; the likelihood that trade restrictions will promote the necessary adjustment in the domestic industry; and the effect on other U.S. industries that might follow from compensatory tariff reductions or trade retaliation abroad.[39] The President's decision is not reviewable. If it differs from the relief recommended by the ITC, however, Congress, through majority vote on a concurrent resolution, may reject it and adopt the ITC's recommendation.[40]

The discretionary nature of escape clause relief is not unique to U.S. law. Although Article XIX of the GATT does not formally require that safeguard action be discretionary, the article plainly envisions that result. Recall under Article XIX that an invoking country must consult, in most cases in advance of action, with countries likely to be adversely affected by safeguard measures. If no settlement is reached, such countries have an automatic right to retaliate.[41] Such a procedure and such consequences plainly suggest the need for executive discretion on whether to grant relief in the first place.[42]

By contrast, the new U.S. countervailing duty law adopts an adjudicatory approach. The Commerce Department and the ITC must decide upon the subsidy and injury questions under statutory language that carefully limits discretion. If the findings are positive, some relief to the domestic industry is guaranteed through either extra duties or an agreement with the exporting country to remove or limit the effect of the subsidy.[43]

The definition of "subsidy" in the new act provides Commerce essentially no room to take into account adverse international consequences if countervailing duties are imposed. The act defines "subsidy" to include expressly, but not exclusively, the Subsidy Code's detailed list of prohibited *export subsidies*.[44] It also gives a narrow definition of domestic subsidy. Under prior practice, the Department of Treasury, which until 1980 administered the countervailing duty law,[45] consistently attempted to maintain flexibility and interpretive discretion, and to emphasize "trade distortion" effects rather than the mere conferral of a government benefit.[46] Thus, under the former approach, the list of factors influencing the characterization of a given domestic measure as a "subsidy" included (1) the magnitude of the benefit given, (2) the tendency of the benefit to increase exports, and (3) the percentage of output actually exported.[47] The new law tilts instead toward the more rigid government benefit theory by failing to include a "trade distortion" requirement[48] and by narrowing the permissible offsets that the Treasury had used in the past to reduce the "net subsidy," in some cases to zero.[49] For example, government grants to encourage location in a depressed region can no longer be reduced by offsetting the increased costs of locating in the region.[50]

The 1979 act also adds a provisional remedy early in the proceeding. The ITC has 45 days, and Commerce 85 days, from the date of the complaint to make preliminary determinations whether there is a "reasonable indication" of injury and subsidization respectively.[51] If these determinations are positive, customs officers suspend liquidation of entries, and the importer must post security for the estimated amount of countervailing duty.[52] In the past, similar preliminary remedies available in anti-dumping cases have often seemed to dampen imports from the inception of the remedy.[53] The rationale for such a remedy reflects its adjudicatory character. Since the practice of subsidization is wrongful, the argument would go, harmful effects should be intercepted as soon as reasonably possible.

An adjudicatory model also can be seen in the new act's provision of frequent opportunities for judicial review. At the instance of either party, the Customs Court may review various preliminary and final decisions by Commerce and the ITC.[54] As a result these agencies must now develop a formal record and their interpretive discretion will be more circumscribed.[55]

Temporary versus Permanent Relief

Finally, relief under the escape clause is temporary. Theoretically, it provides a breathing spell for the industry either to shift workers and resources into other employment or to improve efficiency so as to be able to compete without protection. The escape clause limits trade restrictions to five years and encourages gradual liberalization if the restrictions last beyond three years.[56] The statute provides, however, for one three-year extension of protection.[57]

By contrast, relief under the countervailing duty law is theoretically permanent. Beyond the point at which subsidized imports cause second-level injury, the domestic industry need not adjust at all to the sharper competition caused by the subsidy. Either countervailing duties will counteract the subsidy or the exporting country will agree to remove (or lessen) the subsidy on exports to the United States. Commerce may revoke a countervailing duty order, but only if Commerce or the ITC decides the original grounds for the order no longer exist (either the subsidy has been eliminated or second-level injury would no longer occur or be threatened).[58]

Again these are not distinctions unique to the U.S. law. Although Article XIX does not expressly limit the duration of safeguard action, the Contracting Parties have declared such action to be temporary and emergency in character.[59] The relief period is, at least theoretically, one during which the domestic industry should make the necessary adjustments to cope with heightened foreign competition when the constraints are removed.[60] By contrast, nothing in Article VI of the GATT or in Track I of the Subsidies Code suggests that countervailing duties are emergency measures. Although Article 4(9) of the code provides that "(a) countervailing duty shall remain in force only as long as . . . necessary to counteract the subsidization which is causing injury . . . ," there is not even an implicit obligation on the countervailing country to adjust to the new subsidized trade. Protection against subsidized imports can continue for as long as it is needed.

The distinctions just summarized between escape clause and countervailing duty relief reveal distinctly harsher treatment of bounty-fed as opposed to other imports. Is there a principled basis for this distinction? To analyse that question we turn first in the next section to the rationale for escape clause (safeguard) relief. Thereafter we will examine whether the presence of subsidies alters the case for protection in a way justifying harsher rules.

B. Rationale for Escape Clause Relief

Over time each nation experiences within its economy a different pattern of change in technological innovation, wage rates, capital accumulation, population growth, discovery of new natural resources, and so on. These changes steadily alter the comparative advantage of each country. At any point in time, some industries decline (and face increased import competition) and others expand (and find increased export opportunities).[61] Liberal trade theory has shown convincingly that if governments do not intervene to restrict these changing trade flows, over the *long run* each nation will improve its overall welfare (increase its consumption possibilities).[62] In the *short run*, however, there are at least three separate rationales for government intervention to restrict this process of change: (1) efficiency, (2) equity, and (3) political necessity.[63]

Intervention can be efficient because, in the short run, the cost to society of import-caused dislocation can outweigh the gains from free trade. The gains come through increased consumption possibilities and dynamic influences on innovation and competitiveness. The costs include the forgone output from idle or under-utilized resources (plant, machinery, labour), the expense of adapting resources to other uses (retraining labour, retooling plants), and the human and social losses to workers and communities from uprootment and sudden change. Theoretically, a government should intervene when imports reach a level at which the marginal damage (rising) from the last unit of imports equals the marginal gain (falling) from that unit.[64] In the familiar terms of economic analysis, the goal should be to minimize the sum of (1) the dislocation cost of increased imports and (2) the cost of restricting imports (the lost gains from trade). As a practical matter of course, a nation must base its decision to intervene not on fine measurements of marginal cost and gain, but on grosser measurements of the degree of business injury suffered in an industry (unemployment, idled or under-utilized plant, falling profits, lowered output). In any given case, efficient intervention would require a country to make difficult judgements about whether the necessary degree of gross business injury had occurred, whether increased imports were sufficiently responsible for that injury, and whether a long or short intervention period should be authorized.[65] Intervention after only slight injury, or when imports are only tenuously connected to most of the injury, or for too long a period would reduce overall welfare. In practice, judgements about intervention seem at least vaguely to approximate the appropriate goals.[66]

Several equity concerns can also justify safeguard action. These may include equity in wealth distribution within the safeguarding country and equity or reciprocity between or among nation-states. A free trader generally argues for lower trade barriers because the nation as a whole gains (consumers and those producers who purchase imports or import-competing products) by more than the import-competing industry loses. In theory, the gainers could compensate the losers and still be better off, but free trade policy does not by itself guarantee that compensation will occur, at least not in the short run. In the long run, displaced labour and owners of capital can improve their position by shifting to successful industries. In the short run, however, workers and firms in the import-competing industry will suffer losses.[67] Thus safeguard action may be based on a desire to avoid undesirable short-term wealth distribution effects.

The effect of safeguard action on other countries raises other efficiency and equity issues. For global efficiency in resource allocation, a decision to safeguard should take account of losses inflicted on supplier countries. Thus, in the intervention equation suggested above, the cost of restrictive action should include the costs to foreign country producers. An importing government is neither in a good position to assess those costs, nor would it have much political will to do so if it were. Instead, to some extent the GATT rule that a safeguarding country should offer compensatory trade concessions takes account of costs to foreigners.[68] The rule obviously reflects as well, and perhaps predominantly, fairness notions of balance and reciprocity.

From an invoking country's standpoint, the compensatory concessions rule introduces another set of equitable considerations. A new concession will increase costs to the industries losing protection. On the other hand, if settlement efforts fail and foreign countries retaliate, the invoking country's export industries will be the losers. Thus gains to the safeguarded industry must be balanced against losses to other local industries. (Consumers, of course, experience an opposite set of gains and losses.) The need for such balancing helps further to explain the role of presidential discretion so prominently included in the U.S. escape clause law.[69]

Finally, governments seem often to base safeguard action at least partly on the belief that political necessity requires it. In a given case when imports cause serious market dislocation, a government may conclude that without protective action the political consensus for free trade would collapse. This could be so even if efficiency and equity reasons would not support safeguard action. Thus, pure political necessity cases are those in which the organized and concentrated political power of certain industry groups overrides the unorganized, unarticulated political interests of broader groups like consumers.[70]

A different set of efficiency, equity, and political considerations influences which of the two basic forms of safeguard relief a country adopts. The two are adjustment assistance (subsidies to firms and workers) and trade restrictions (tariffs, quotas, and special agreements under which other countries agree to restrain exports). Economists have demonstrated that adjustment assistance would be the most efficient policy.[71] Subsidies can pin-point relief to firms and workers most seriously affected by import competition and encourage appropriate adjustment. They would also not raise prices to consumers. Nevertheless, pragmatic, administrative, political, and even equity considerations may lead a nation sometimes to prefer trade intervention. The bureaucratic-administrative expense of subsidies in a given case could be higher than those associated with trade measures.[72] Moreover, the fiscal cost of subsidies is explicit. Subsidies must be included in annual budget allocations and must be financed from tax revenues. Hence, both government officials and industry may prefer the more hidden tax and subsidy effects of trade measures.

Among trade measures, a country may prefer a quota system or voluntary restraint agreement over a tariff for several reasons. An invoking country may use the former measures to protect the market share of established trade partners, from whom trade retaliation could be particularly damaging. Restraint agreements and properly structured quotas also distribute the scarcity value of the reduced import stream to the exporting country. A tariff, by contrast, captures it for the safeguarding nation. Thus a kind of "international equity" may underlie resort to these measures despite the greater relative efficiency of tariffs.

C. Absence of Rationale for Countervailing Against Domestic Subsidies

It should be recalled that under U.S. law, escape clause relief is *discretionary*, triggered at *first-level injury*, and *temporary*. Countervailing duties, on the other hand, are *non-discretionary*, triggered at *second-level injury*, and essentially *permanent*. The countervailing duty law also provides no option for adjustment assistance as an alternative remedy. These distinctions raise the fundamental question: is there a principled basis for harsher treatment of subsidized by contrast with non-subsidized imports?

Proponents of Track I relief normally give two major reasons for countervailing duties: (1) subsidies distort trade (they are inefficient)[73] and (2) subsidized trade is unfair (inequitable).[74] Since efficiency and equity reasons also underlie safeguard action, the question becomes whether these considerations operate with more or different force when imports are subsidized. This section will consider the rationale for countervailing against imports aided by a domestic subsidy. The next section will address the rationale for countervailing against export subsidies.

The Efficiency Argument

To analyse the efficiency claim against domestic subsidies, let us assume that Utopia grants a wage subsidy to its local shoe industry in a depressed region. Assume also that Utopia exports shoes to the United States and that these cause *second*- but not *first*-level injury to the American shoe industry. The typical efficiency claim against the Utopian subsidy would seem to rest on three premises. First, one must argue that the subsidy distorts production within Utopia and hence causes inefficiencies there. Secondly, this must result in some special harm to the United States not present in the absence of a subsidy. Thirdly, a countervailing duty must be a reasonable way to remedy the harm.

Each of these premises is either very weak or insupportable. For theoretical and practical reasons, one cannot know or reasonably decide that a given Utopian subsidy is in fact inefficient within Utopia. Moreover, even if inefficiency within Utopia were an established fact, the United States would not necessarily advance its own efficiency interests by countervailing against Utopia's subsidy.

The Utopian wage subsidy could actually enhance Utopian efficiency in a number of ways. If temporary, it could operate to avoid the inefficiencies of sudden dislocation in an ailing shoe industry. Even if more or less permanent, the subsidy could be an efficient way of counteracting the distortions of downwardly rigid wage rates or the monopoly power of Utopian unions. Plainly, a U.S. countervailing duty law would be unworkable if it required an American agency to measure the precise *amount* or *duration* of the Utopian wage subsidy needed for internal Utopian efficiency. Moreover, there would seem no basis for a rule that simply presumes inefficiency — that is, one that presumes the Utopians always or usually "get it wrong."[75]

Furthermore, Utopia may not be aiming at efficiency in the normal sense. It may be aiming at what is sometimes called a non-economic goal. Increased shoe production in a depressed region in Utopia may be a "public good" analogous to the public good of a guaranteed domestic capacity for steel production (in the latter case for national security reasons).[76] It may be a goal that society at large in Utopia desires, but that the private market could not provide. Utopia might simply want to decentralize production and population or to revitalize depressed regions. How could the United States ever decide that Utopia's wage subsidy was wasteful because its cost to Utopian society outweighed its public good benefits to that society? Of course the wage subsidy might actually reflect only the political power of Utopia's shoe industry. It might represent a transfer of wealth from Utopian society at large to workers and producers in the shoe industry not based on efficiency or public good goals. But the point remains that no realistic U.S. procedure could ever decide that issue.

More tellingly, however, even if we start with an assumption that the wage subsidy is inefficient within Utopia, it does not follow that the United States would improve its own efficiency (expand its consumption possibilities) by countervailing against subsidized Utopian shoes. An inefficient subsidy in Utopia could of course have negative consequences for the United States. The misallocation of resources to shoe production in Utopia would generate higher costs and hence higher prices for some other Utopian product, for example, widgets. If the United States is an importer of Utopian widgets, it will be hurt by the higher widget prices. But is a countervailing duty the proper remedy for such harm? If the new American duty does not induce Utopia to abandon its wage subsidy, American consumers and intermediate producers will have the worst of both worlds: higher prices for Utopian widgets and higher prices for Utopian shoes.

Even assuming American countervailing duties (perhaps in conjunction with similar measures in other countries) cause Utopia to remove its shoe subsidy (or deter it from other distortive subsidies), it does not follow that the United States would thereby reap welfare benefits. Unless imports cause first-level injury, the United States must on balance benefit from low-priced, subsidized Utopian shoes. If the subsidy is removed, the United States will receive a net benefit only if it gains more in welfare through reduction in the price of Utopian widgets than it loses from the increase in the price of no-longer-subsidized Utopian shoes. In the real world, the outcome of such a calculus would almost always be indeterminate.

Over the long term, one might nevertheless favour a rule that forbade inefficient domestic subsidies and authorized effective deterrents to them. The increased global efficiency over time might be expected to benefit all nations, even if no one could say in a particular case who were the net gainers and losers. But of course the rule would still rest on the weak premises discussed above: (1) the difficulty or ambiguity of either (*a*) deciding unilaterally that a domestic subsidy in a foreign country is inefficient or (*b*) presuming so without justification; and (2) the unlikely deterrent effect of a countervailing duty. Such a measure is most likely to cause the target country to remove the subsidy only on exports to the countervailing country, not completely. In the former case, of course, the distortive effects of the subsidy would remain essentially unchanged.

A further efficiency argument for countervailing duties could rest on the costliness of adjusting to foreign government measures likely to be impermanent. With the stroke of a pen, foreign subsidies may go on or come off. One could argue that trade flows caused by changes in comparative advantage would not be as volatile or impermanent. Hence adjustment to them would be less wasteful. Of course such an argument would not apply at all to the many non-repetitive subsidies such as investment incentives. Even for continuing subsidies, however, one could not easily calculate whether the gains from trade for the period of the subsidy fall short of the costs stemming from industry adjustment when the subsidy goes on and readjustment when it comes off. Plainly such a calculus would not justify treating all domestic subsidies the same, much less countervailing against them automatically at second-level injury. At most, the potential for impermanence might justify giving the President added discretion to take into account past or expected volatility in foreign subsidy practices in the decision whether to invoke protection or to extend the time period of protection. This could be incorporated into the President's existing escape clause discretion or made a part of the trade retaliation process (Track II) to be discussed later.

A different, but related, efficiency argument for countervailing duties could rest upon the possibility that foreign subsidies would distort investment decisions in the United States. American firms might be reluctant to expand or to invest in an industry likely to receive government aid abroad. One answer to such a claim, however, is that to be efficient, American investment decisions should in fact take account of the likelihood that foreign competitors will receive or continue to receive local subsidies. There are other uncertainties about foreign competitors that an American investor must estimate: whether foreign competitors will achieve breakthroughs in technology or management skills, whether the inflation rate in a foreign economy will remain constant, whether a given exchange rate will fluctuate, and so on. It is not clear that foreign subsidy policy is less predictable than these other factors, or that adding this additional element of uncertainty would significantly distort the investment process in the United States. Of course uncertainty, disruptiveness, and volatility in the world economy are a potential concern, especially if subsidies proliferate in undisciplined and wasteful fashion. That concern would seem better met, however, through a mechanism for multilateral GATT surveillance and government-to-government negotiation and compromise than through unilateral and automatic countervailing duties, triggered and essentially controlled by a private complainant. The multilateral surveillance-negotiation approach roughly describes Track II of the Code, which this essay endorses as a sensible regime for subsidies.

The Equity Argument

The equity or fairness argument for countervailing duties rests upon notions of inequality and fair play at the private-firm level. Domestic producers argue that it is unfair for them to compete against an entire foreign government or against foreign competitors propped up by subsidies.[77] The United States requires its own producers to comply with the competitive market model — survival of the most efficient — and favours free trade as an extension of that principle. On the other hand, the expanded market, absent countervailing duty laws, brings in competitors who play by different rules and who are not subject to the discipline of the market. Common-sense notions of fair play seem violated.

Despite its surface plausibility, however, this fairness claim is unpersuasive for several reasons. First, if one includes the effects of all government action, not just isolated subsidies, the balance of fairness to any group of producers, domestic or foreign, becomes quite unclear or indeterminate.[78] Government action both at home and abroad benefits industry in innumerable ways: through public roads and education, sound fiscal and monetary management, maintenance of law and order, and so on. As these actions filter through, no one can say which firms derive a relative net benefit or burden. Of course, government policies with very generalized effects on an economy could easily be merged into the general background of factor endowments that condition all national output and thus, for trade purposes, be ignored.[79] The new U.S. countervailing duty law in fact excludes from the subsidy definition government benefits with widespread economic effects.[80] Selective subsidies with visible, particularized effects, on the other hand, might be thought to raise the fairness problem more acutely. Even accepting such an imprecise notion of inequality, however, there are further weaknesses in the argument.

The concept of equality for producers underlying the fairness argument clashes head on with free trade policy; it is not merely a qualification of it. The very notion of deriving benefits from trade presupposes inequality of productive conditions: wage rate, natural resource availability, energy costs, technological advancement, managerial skills, and so on. If fairness requires equality in productive conditions, trade would come to a halt. The United States only imports shoes from Utopia because Utopia has some advantage in producing shoes.

It is also unpersuasive to argue that equality should at least extend to government-defined conditions of production, as opposed to "natural" or "market" conditions. This amounts to an argument that wealth distribution in the United States should mirror the pattern chosen in Utopia. Assume that Utopia taxes society at large to aid its shoe industry. That transfers wealth from consumers in Utopia to shoe producers in Utopia and to Americans who buy the cheaper Utopian shoes. When the subsidized Utopian shoes cause second-level injury to American shoe producers, a countervailing duty taxes away the benefit to the American consumer and transfers it in part to American shoe producers through the higher domestic prices the new duty facilitates. The equity claim for this result is not, however, that capital owners, managers, or workers in the American shoe industry are especially deserving or that the degree of injury to them is intolerable. As we know from the analysis of the American escape clause, that might be said at first-level injury, but not at lesser levels. The only distinguishing equity feature between second-level injury caused in one case by non-subsidized imports and in the other by bounty-fed imports seems to be that in the subsidy case, Utopian producers are receiving a benefit from their government. Thus the transfer from American consumers to American shoe producers is urged at second-level, instead of first-level injury, and under non-discretionary, permanent relief procedures only because Utopia has chosen a prior and similar transfer from consumers to producers in Utopia. There seems nothing compelling in such an argument.

Moreover, the Utopian shoe subsidy may be aimed in part at decentralizing the population or aiding a depressed region, factors that would not likely be mirrored in the United States. Thus the equity argument for equality of government-defined productive conditions is further flawed. The American transfer policy inherent in countervailing duties may be much more costly to American consumers than is the original producer-benefiting policy in Utopia to Utopian consumers, because the latter receive indirect benefits from achievement of the collective goal.[81] Cross-country equality for producers is not matched by cross-country equality for consumers.

Equity or other public policy goals may of course support wealth transfer programmes in the United States to aid ailing industries, workers, or communities. The American safeguard law is one such programme. When injurious imports are spurred on by a foreign subsidy, instead of a technological innovation, the private-firm equity claim for relief seems to gain no added weight. From the standpoint of fairness to American producers, the foreign *cause* of the increased flow of imports seems irrelevant.

D. Absence of Rationale for Countervailing Against Export Subsidies

At the private-firm level, the equity argument for countervailing against export subsidies seems no different from that just discussed for domestic subsidies.[82] The efficiency issue, on the other hand, is different. One can make a good case that export, as opposed to domestic, subsidies are generally distortive (inefficient). A countervailing duty regime would nevertheless still not seem an appropriate remedy for any consequent losses to the importing country.

To examine first the point that export subsidies are generally distortive,[83] let us assume this time that Utopia grants a subsidy only on shoes exported from Utopia. Thus the subsidy is restricted to the trade sector and operates like a "negative tariff." It also produces distortions analogous to those of a tariff. Excessive resources are devoted to shoe production in Utopia, and too much of the resulting output is exported. In effect, Utopian consumers must pay a higher price for Utopian shoes than that paid by foreign consumers because the subsidy drives the price of exported shoes down (or has some equivalent effect if price is unchanged).[84]

With a domestic subsidy, one can always argue plausibly that apparent inefficiencies are really the necessary and appropriate cost of advancing a collective purpose or non-economic goal in Utopia. The same argument is not as persuasive when applied to an export subsidy. Except for cases of economic or military aid, no country has a plausible collective interest in exporting an above-market quantity of a particular good.[85] Of course by subsidizing shoe exports, Utopia may seek indirectly to aid shoe producers and the region in which the industry is located. But an export subsidy is less efficient than a domestic subsidy for that purpose.[86] While an export subsidy encourages production, it also opens an inefficient price gap (or its equivalent) between the world and home markets for shoes. The price for shoes in Utopia is driven higher than it should be.

Similarly, an export subsidy on shoes would be an inefficient policy for correcting a market distortion in shoe production within Utopia. If wages in the shoe industry are too high because of a market rigidity, for example, the efficient remedy would be a wage subsidy in the shoe industry. A subsidy limited to shoes exported, while countering the internal market rigidity to some extent, would at the same time open new distortions.[87]

But establishing that export subsidies are generally distortive does not complete the argument for countervailing duties. Nor does it suffice to point out that such distortions in Utopia can harm the United States by driving up the price of some other U.S. imports from Utopia (widgets). A countervailing duty will counteract the export subsidy only on shoes going to the United States, not on shoes going to other countries. Hence, most of the distortion will remain. The higher price of Utopian widgets will continue and will be joined by a higher price in the United States for Utopian shoes caused by the countervailing duty. Alternatively, if the real concern is for the indirect benefits all countries derive from a more efficient global economy, the goal should be global deterrence of export subsidies as a general rule. As we shall see, Track II, by contrast with Track I, is at least a plausible means to that end.

IV. Track II — Trade Regulation

A. An Overview of Track II — Section 301 Relief

Track II of the Subsidies Code accomplishes two important changes in GATT law. First, it defines more precisely the legitimate limits on the use of subsidies. Secondly, it provides a more streamlined procedure for settling intergovernmental disputes over the trade effects of subsidies.

The code's most important limit on the use of subsidies is its outright prohibition on "export subsidies" to manufactured and mineral products.[88] That prohibition is not conditioned, as before, on exports being at a lower price than domestic sales.[89] The Annex to the Subsidies Code contains an illustrative list of prohibited export subsidies, all of which, following the definition given earlier, condition the subsidy on export or export performance.[90] Although the code excludes export subsidies on agricultural products from this general prohibition, it tightens the prior rules for using such subsidies.[91] The code treats domestic subsidies of all kinds less harshly. It recognizes that a domestic subsidy is a legitimate means of pursuing an internal social or economic purpose.[92] It obligates signatories using such subsidies only to "seek to avoid causing" adverse effects to the interests of other signatories.[93]

While Track II sets up a formal government-to-government complaint procedure, at the same time it strongly encourages a negotiated settlement. It does so by providing initial periods first, for inter-party consultations[94] and, secondly, for formal conciliation by the Committee of Signatories.[95] If the dispute remains unresolved, the Committee appoints a panel to find the facts and apply GATT law. If the panel's report does not spur a settlement, the Committee must make recommendations to the parties and ultimately decide whether to authorize retaliation.[96] The entire process may not last longer than seven months.[97]

The dispute settlement provisions distinguish sharply between export and domestic subsidies. If the complaining government establishes that a signatory has used a prohibited export subsidy, a presumption of adverse effects to the complainant arises.[98] If the subsidizing country fails to rebut that presumption[99] or reach a settlement, the Committee of Signatories would presumably authorize trade retaliation.[100]

If the complaint attacks a domestic subsidy, however, the complaining government must itself prove that the subsidy has either reduced its exports or damaged its domestic industry through increased imports.[101] The principles that govern relief in such cases will be discussed in more detail later.

The Trade Agreements Act of 1979 incorporates these Track II provisions into U.S. law by amending the President's special trade retaliation authority in section 301 of the Trade Act of 1974.[102] Under these new provisions, a private petition to the United States Trade Representative (formerly the Special Representative for Trade Negotiations)[103] can trigger U.S. retaliation rights under Track II of the code.[104] If the Trade Representative decides to open an investigation, section 301 instructs him simultaneously to invoke the Track II dispute settlement procedures. Failing a negotiated settlement, the Trade Representative must recommend to the President appropriate retaliatory action.[105] But that recommendation is not due until after the code dispute resolution process has run its course.[106] In a private petition case, the President must decide what action to take, if any, within twenty-one days of the Trade Representative's recommendation,[107] which has no binding force. Counting that period and the initial forty-five days allowed for the decision whether to open an investigation, section 301 limits the total lapsed time from petition to presidential decision in an export subsidy case to approximately nine months,[108] and in a domestic subsidy case to approximately ten months.[109]

The President has complete discretion whether to retaliate against the trade of an offending country.[110] Section 301 does not expressly condition his authority upon the Committee of Signatories' authorization, nor does it limit the degree of retaliation he may employ. On the other hand, under the code the United States has an international obligation not to retaliate against signatories without authorization of the Committee of Signatories.[111] If the Committee authorizes retaliation, it must take into account the nature and degree of the subsidy-caused adverse effect to the interests of the complaining government.[112]

B. Track II and Displaced Exports

The Track II–section 301 provisions just discussed are easier to justify when they prevent displacement of exports than when they curtail imports. We will consider the protection of exports here and the curtailment of imports in the next section. For an American exporter who loses market share abroad because of a foreign subsidy, Track II–section 301 is the only available remedy. Moreover, the United States normally has an unambiguous interest in pursuing that remedy, because avoidance of export displacement simultaneously aids both major trade policy constituencies. Producers will increase their sales, and consumers will gain a larger basket of imports.

This last result requires explanation. It occurs because a country must export to pay for its imports. If foreign subsidies displace the optimal pattern for U.S. exports, an alternate pattern of equal value in world markets will be more costly to produce. From the opposite perspective, if the complement of resources allocated to producing goods for export remains the same both before and after displacement, the resulting export pattern will have less value on world markets and hence will "purchase" only a smaller basket of imports.

Protecting against displacement of exports to third countries at the hands of the *export subsidies* of other countries is the easiest application of Track II to justify. When such subsidies displace American exports, they reduce global efficiency and unambiguously injure U.S. interests. They force U.S. producers to shift into less efficient lines of output; U.S. consumers do not benefit from low-priced imports; and the subsidy-created inefficiencies within Utopia may indirectly increase the cost of some other Utopian export to the United States. These detrimental effects and the general lack of justification for export subsidies support the Track II requirement that the subsidizing country must show an absence of displacement. The advantages to the complainant in such a proceeding should encourage complaints and consequently discourage the use of such subsidies. That in turn will improve the efficiency of the global trading system from which all trading nations will benefit in the long run. Thus a Track II complaint against an export-displacing export subsidy advances simultaneously the national interest of the complainant and the global interest in efficiency.[113]

Domestic subsidies can similarly displace other-country exports, both to third countries and to the subsidizing country itself. But because domestic subsidies are not presumptively inefficient, it is difficult to say what principles should guide the necessary trade-off between the entirely legitimate but conflicting interests of the subsidizing and non-subsidizing nations. Under what conditions should the Committee of Signatories say that Utopia should adjust a wage subsidy to shoe producers, for example, to eliminate or lessen the displacement effect on U.S. exports? In this context, Track II provides no generally applicable burden-shifting rule, as with export subsidies, and no unilateral right (like that incident to countervailing duties) to retaliate on the basis of weak injury. Instead, under the procedure described above, the code realistically emphasizes inter-party negotiation and compromise, which could lead to the most felicitous resolution of disputes.

If all efforts at negotiated compromise fail, the language of the code and past GATT practice suggest some guide-lines for the Committee's decision whether to authorize retaliation. Under the nullification or impairment of benefits provisions of Article XXIII of the GATT, the Contracting Parties have drawn as much as possible upon past negotiated understandings between the parties. Thus, if Utopia grants the United States a tariff binding on shoes, the Contracting Parties would apparently find a subsequent Utopian subsidy on shoe production to constitute prima facie nullification or impairment of benefits.[114] The words "prima facie" in this context mean that the United States would be entitled to a declaratory judgement in its favour even if the Committee did not have clear statistical evidence that the shoe subsidy displaced American exports.[115] Hence, a limited burden-shifting rule applies. In the few past cases of this kind on record, the declaratory judgement alone led to a settlement.[116] Of course the Committee would need some evidence of the magnitude of displacement before it could authorize an appropriate degree of retaliation if that became necessary.

When the subsidy is not on a bound product or when it displaces a complainant's exports to third countries, the Committee will presumably require statistical evidence of trade diversion. In most cases a complainant will have difficulty showing such diversion.[117] Hence, the code in effect provides large leeway for unhindered use of domestic subsidies. And the Committee could increase that leeway by deciding that the required displacement must exceed some threshold of magnitude, perhaps vaguely defined.

Should a complainant overcome these hurdles and show the necessary trade displacement, however, the Committee could authorize trade retaliation. That may seem odd. After all, the code does not expressly require a signatory employing a domestic subsidy to avoid displacing the exports of other signatories. It says merely that signatories shall "*seek* to avoid causing such effects. . . ."[118] Nevertheless, the GATT Contracting Parties have not traditionally required breach of a legal obligation as a prerequisite to finding Article XXIII nullification or impairment of GATT benefits.[119] In fact, one of the GATT's past findings of non-violation nullification or impairment under Article XXIII involved the displacement effect of domestic subsidies.[120] The code is expressly intended to implement Article XXIII[121] and seems to draw upon this past practice when it lists various effects of domestic subsidies that may demonstrate nullification or impairment. These include (1) "displacing or impeding the imports of like products into the market of the subsidizing country" and (2) "displacing the exports of like products of another signatory from a third country."[122] Thus, without doing so expressly, the code nevertheless seems to impose a quasi-duty on signatories not to use domestic subsidies in a manner that seriously displaces the exports of another signatory.

The Committee may also develop a qualitative test of nullification or impairment. The code language that could be significant here appears in Article 11(2). After recognizing that domestic subsidies may cause nullification or impairment of benefits, Article 11(2) states: "in particular where such subsidies would adversely affect the conditions of normal competition." One could argue that if there is no such adverse effect on normal competition, nullification or impairment should not usually, if ever, be found. Thus, where a subsidy is arguably non-distortive or merely corrective of a prior market distortion — so that normal competition is maintained or restored, not "adversely affected" — the Committee could decide that no amount (or only a greater than otherwise required amount) of trade displacement would produce nullification or impairment. An example of such a non-distortive measure might be a wage subsidy in the Utopian shoe industry to offset pronounced downward rigidity in the wage rate or a subsidy to investment in depressed regions of Utopia carefully calculated to offset only the added cost to a firm of locating in the depressed region. The Committee could analogize such a "non-distortive" subsidy to a technological innovation in Utopia. If a technological innovation in the Utopian shoe industry displaced American shoe exports, the United States would have no basis for claiming nullification or impairment of GATT benefits.

Still, such a qualititative test would force the Committee into the thicket of deciding about the efficiency effects of domestic subsidies and the relevance to that inquiry of arguments about public goods. Such problems could be better handled under a different compromise regime for domestic aids, but one still drawing upon both qualitative and quantitative principles. The signatories could group domestic subsidies into different categories, such as aid to depressed regions, aid to research and development, and aid to ailing sectors and firms. They might then negotiate quantitative limits and other standards for government assistance in each category. This is essentially the European Community approach to domestic aids within the Common Market.[123] Such an approach would give the signatories an opportunity collectively to legitimize in varying degrees the non-economic goals underlying different subsidy programmes. So far, however, there are no signs that this kind of consensus will develop at the GATT level in the near future.

In summary, Track II with its emphasis upon flexibility, negotiation, and pragmatic compromise seems a sound approach to disputes over export-displacing domestic subsidies. The problem at its core requires some fair basis for trading off against one another two legitimate but conflicting sovereign interests. Where negotiation and efforts at inter-party compromise fail, the dominant trade-off device seems likely to be a non-violation-nullification-or-impairment right to retaliate if the Committee of Signatories finds sufficient trade displacement.

C. Track II and Injurious Imports

As already noted, Track II applies as well when bounty-fed imports injure a complainant's domestic industry. In this area Track II overlaps with Track I, and a complaining government could pursue either remedy or both simultaneously. Because an importing country can apply Track I countervailing duties unilaterally, industry complainants are likely to prefer that remedy. Track II may be attractive, however, when the offending measure is a prohibited export subsidy. Under the prima facie nullification or impairment concept, this would shift to the subsidizing government the burden of showing an absence of injury.

As with Track I countervailing duties, Track II in this use overlaps with a safeguard remedy. All the arguments above favouring adjustment assistance and escape clause relief (the American safeguard law) over countervailing duties apply with equal force here. Even when the offending measure is a presumptively distortive export subsidy, neither efficiency nor private-firm fairness claims seem adequate to explain resort to standards other than those of the escape clause and adjustment assistance. A different fairness argument, however, may distinguish Track I from Track II in this area and justify having the additional Track II remedy, especially as implemented in U.S. law.

That argument rests on considerations of reciprocity and fairness at the intergovernmental level and on the strong element of executive discretion in a section 301 proceeding. Under Track I countervailing duties — at least under U.S. law — a private complainant has a legal right to relief if successful in showing the existence of a subsidy and second-level injury. By contrast, under section 301, the executive has discretion whether to press a complaint and ultimately whether to retaliate. This element of executive discretion not only aligns the section 301 remedy more closely with escape clause relief, which is also discretionary, but accords more directly with the need for political judgement and flexibility when dealing with clashing governmental policies. The importance of fairness, balance, and reciprocity between governments raises a different consideration than that present at the private-firm level.

For example, suppose that the American steel or auto industry falls upon bad times, and the United States pursues various programmes of revival. The Chrysler loans[124] and the trigger price mechanism for steel[125] might be examples. One could argue that these programmes reflect non-economic, public-good goals in the United States. Suppose Utopia, experiencing similar difficulties in its auto and steel industries, grants large production subsidies that increase auto and steel exports to the United States. In this context, the United States may rightfully consider such Utopian action to have an unfair, beggar-thy-neighbour character to it, especially if Utopia employs aggressive export subsidies. Faced with such irresponsible Utopian action, the United States under the code could pursue a Track II complaint seeking to single out Utopian imports for selective restrictions. Here the Track II presumption against export subsidies would seem justified. Were Utopia to use a domestic subsidy, the United States would of course have to convince the Committee of Signatories to authorize retaliation. But the significant feature of such a Track II case, by comparison with a safeguard proceeding, would lie in its government-to-government complaint character. The United States goal here would be to impress upon the Utopian government that its actions had detrimental effects upon goals of the U.S. government for its own industry. Such a situation would not arise every time a foreign subsidy caused second-level injury within the United States, the triggering level for countervailing duties. Such automatic "retaliation" would be too sweeping and indiscriminate. But a discretionary Track II procedure could be useful in special circumstances to supplement a safeguard law.

V. Conclusion

This study of the new Tokyo Round Subsidies Code and corresponding United States law has reached a relatively simple conclusion. The Track I–countervailing duty approach to subsidies seems unwise and protectionist. An importing country's need to occasionally limit injurious imports should be met essentially through its safeguard law — in the United States through the escape clause and adjustment assistance remedies. Neither efficiency nor private-firm fairness claims justify a special, harsher countervailing duty law for bounty-fed imports. On the other hand, the discretionary, Track II–section 301 approach to subsidies seems sound. This is especially so when a Track II complaint is aimed at preventing the loss of exports. And this is likely to be its major use. A plausible case can also be made for discretionary presidential authority under Track II–section 301 to single out subsidized imports for selective retaliation in special circumstances, for example, when a foreign government is acting irresponsibly in times of global market glut.

Notes

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[1] Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, GATT Doc. MTN/NTM/W/236 [hereinafter cited as Subsidies Code]. Reprinted in *Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations*, H.R. Doc. No. 96–153, 96th Cong., 1st sess., 1979, p. 257.

[2] Government negotiators developed the terminology Track I and Track II for the Subsidies Code. For an early use of the terminology, see *American Society of International Law, Proceedings of the 73rd Annual Meeting* (1979), pp. 66–70 (remarks of C. Fred Bergsten, Assistant Secretary for International Affairs, U.S. Dept. of the Treasury). Track I includes Articles 1–6 of the Subsidies Code.

[3] Track II includes Articles 7–19 of the Subsidies Code.

[4] The acronym GATT refers to the General Agreement on Tariffs and Trade, opened for signature 30 October 1947, 61 Stat. A-11, T.I.A.S. No. 1700, 55 U.N.T.S. 1974, and the organization that implements the agreement [hereinafter cited without cross-reference as GATT]. The text of the basic agreement and various annexes are reprinted in *General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents*, 4th Suppl. (1969) [hereinafter cited without cross-reference as BISD].

[5] For a brief statement of the reasons for that failure, see *Twenty-fourth Annual Report of the President of the United States on the Trade Agreements Program* (Washington, D.C.: 1979), pp. 72–73 (failure to reach agreement on (1) whether to permit safeguard restrictions against selective countries and (2) whether to regulate various types of restrictive action now effectively outside the discipline of GATT, such as voluntary restraint agreements); and T. Graham, *The Impact of the Tokyo Round Agreements on U.S. Export Competitiveness* (Washington, D.C.: Centre for Strategic and International Studies, 1980), p. 46.

[6] For an argument that anti-dumping laws should also be replaced largely by safeguard relief, see John J. Barceló III, "The Antidumping Law: Repeal It or Revise It," in *Antidumping Law, Policy and Implementation, Michigan Year Book of International Legal Studies* 1 (1979): 53–93 (Ann Arbor: University of Michigan Press).

[7] See Rodney Grey, "Some Commercial Policy Problems Ahead," speech delivered in Toronto to the Conference Board in Canada, 26 September 1979, pp. 9–10.

[8] See Richard R. Rivers and John D. Greenwald, "The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences," *Law and Policy in International Business* 11 (1979), pp. 1448–49; and *American Society of International Law*, pp.64–66.

[9] The prior law provided an injury test only for non-dutiable products. See 19 U.S.C. § 1303 (1976) (amended 1979). That law is still in effect for countries that have (1) not become parties to the Subsidies Code, (2) nor accepted equivalent obligations, (3) nor entered into agreements entitling them to unconditional MFN treatment. 19 U.S.C. § 1671(b) (1)-(3) (Supp. III 1979). Countries that have entered agreements in this last category are listed in U.S., Congress, Senate, Committee on Finance, *Trade Agreements Act of 1979*, S. Rep. No. 96–249, 96th Cong., 1st sess., 1979, p. 45 [hereinafter cited as Senate Report] (El Salvador, Honduras, Liberia, Nepal, North Yemen, Paraguay, and Venezuela).

[10] Subsidies Code Article 9. The code imposes less severe restrictions on export subsidies to agricultural products. These are impermissible only if they give the subsidizing country "more than an equitable share of world export trade" in the subsidized product. *Ibid.*, Article 10(1), measuring the market shares in "the three most recent calendar years in which normal market conditions existed." *Ibid.*, Article 10(1), (2)(c). "More than an equitable share" includes any case where the subsidized goods "displace the exports of another signatory" in established markets. *Ibid.*, Article 10(2)(a). In determining "equitable share" in new markets, the code takes into account "traditional patterns of supply of the product concerned to the world market, region or country, in which the new market is situated." *Ibid.*, Article 10(2)(b). The code also prohibits export subsidies on agricultural products to a particular market that result in "prices materially below those of other suppliers to the same market." *Ibid.*, Article 10(3). Reference throughout this article to "prohibited export subsidies" means export subsidies to manufactured and mineral products, and those to agricultural products that violate the Subsidies Code principles outlined above.

[11] Although the code recognizes domestic subsidies as legitimate for internal social and economic purposes, Subsidies Code Article 11(1), a subsidizing country agrees to try to avoid using such subsidies in a manner that would adversely affect the interests of other signatories. Subsidies Code Article 11(2).

[12] See Subsidies Code Articles 12, 13, 17–19.

[13] *Ibid.*, Article 11(1).

[14] *Ibid.*, Annex (listing expressly prohibited export subsidies).

[15] Compare the code prohibition of export subsidies in Article 9 with its qualified acceptance of domestic subsidies in Article 11.

[16] See Subsidies Code Articles 3–6.

[17] *Ibid.*, Articles 3–4.

[18] *Ibid.*, Article 2(1) n. 1.

[19] *Ibid.*, Article 13(3).

[20] 19 U.S.C. §§ 2251–2253 (1976 and Supp. III 1979) (escape clause); 19 U.S.C. §§ 2271–2322 (adjustment assistance to workers); 19 U.S.C. §§ 2341–2354 (adjustment assistance to firms).

[21] 19 U.S.C. §§ 2251–2253 (1976 and Supp. III 1979). A "substantial cause" is one that is "important and not less than any other cause." 19 U.S.C. § 2251(b) (4) (1976).

[22] See generally note 20.

[23] See generally 19 U.S.C. §§ 2252–2253 (1976 and Supp. III 1979) (President's range of choices and discretion).

[24] See John H. Jackson, *World Trade and the Law of GATT* (New York: Bobbs Merrill, 1969), pp. 564–66.

[25] 19 U.S.C. §§ 1671a(b), 1677(9) (C)-(E) (Supp. III 1979). The Commerce Department has been assigned the role the statute describes as that of the "administering authority." See Reorganization Plan No. 3 of 1979, § 5(a) (1) (C), 44 *Federal Register* 69, 273 (1979).

[26] 19 U.S.C. § 1671(a) (1) (Supp. III 1979). For Commerce's new countervailing duty regulations, see Countervailing Duties 19 C.F.R. §§ 355.0–355.44 (1980).

[27] 19 U.S.C. § 1671(a) (2) (Supp. III 1979). The new act authorizes the imposition of countervailing duties upon a showing of material injury, threat of material injury, or material retardation of the establishment of a United States industry. *Ibid*. This article will use the term "material injury" to include all three concepts. For the ITC's new regulations on the material injury determination, see 19 C.F.R. §§ 207.1-207.51 (1980).

[28] 19 U.S.C. § 1671e (Supp. III 1979).

[29] Compare GATT Article VI and Subsidies Code Article 4 (no mention of right to retaliate) with GATT Article XIX (3)(a) (express right to retaliate against country invoking escape clause).

[30] 19 U.S.C. § 2251(b) (4) (1976).

[31] 19 U.S.C. § 1671(a) (Supp. III 1979).

[32] 19 U.S.C. § 1677(7) (A) (Supp. III 1979). Assuming the concept "material injury" covers a range of business injury, Congress's definition plainly aims at the very lowest end of that range.

[33] See *Senate Report*, p. 87; and U.S., Congress, House, Committee on Ways and Means, *Trade Agreements Act of 1979*, H.R. Rep. No. 96–317, 96th Cong., 1st sess., 1979, p. 46 [hereinafter cited as House Report].

[34] The House Report expressly rejected the "de minimis" test employed in ITC decisions in the late 1960s. See *House Report*, p. 46. See also *Senate Report*, p. 87. For a discussion of the ITC cases, see John J. Barceló III, "Antidumping Laws as Barriers to Trade — The United States and the International Antidumping Code," *Cornell Law Review* 57 (April 1972), pp. 544–58.

[35] See David E. Birenbaum and William P. Alford, "International Trade: Subsidies/Countervailing Duty Code: New Consensus for International Trade?" *The National Law Journal* 1 (25 June 1979), p. 23, col. 3; John Slayton, "The Trade Agreements Act of 1979: Material Injury Standard," *Journal of International Law and Economics* 14 (1979), pp. 98–99; and Barceló, "The Antidumping Law . . . ," pp. 54–57 (comparing the injury test under the escape clause with the injury test under the anti-dumping law, as amended by the Trade Act of 1974).

[36] *Senate Report*, pp. 57–58; *House Report*, p. 47.

[37] The significance of the causation test is dramatically visible in the recent 3–2 escape clause decision of the ITC refusing to recommend relief for the automobile industry. Although the ITC found the industry was suffering serious injury, it failed to find that imports were a "substantial cause" of that injury. Instead it found depressed economic conditions (decline in aggregate demand) and consumer preference for smaller, more fuel-efficient cars (shift in demand) to be more important causes of the industry's difficulties. *Certain Motor Vehicles and Certain Chassis and Bodies Therefor*, Report to the President in ITC Investigation TA–201–44, ITC Publication 1110 (December 1980).

[38] *Bolts, Nuts and Screws of Iron or Steel*, Report to the President in ITC Investigation TA–201–2, ITC Publication 747 (November 1975), p. 10 (views of Chairman Leonard); S. Rep. No. 1298, 93d Cong., 2d sess. (reporting on Trade Reform Act of 1974), p. 212.

[39] 19 U.S.C. § 2252(c) (1976).

[40] 19 U.S.C. § 2253(c) (Supp. III 1979).

[41] See note 24.

[42] The role of discretion here is distinguishable from excessive "bureaucratic discretion in matters of emergency protection," that some commentators argue leads to a protectionist bias. Jan Tumlir, "Emergency Protection Against Sharp Increases in Imports," in *In Search of a New World Economic Order*, edited by Hugh Corbet and Robert Jackson (New York: Wiley, 1974), p. 281. Critics of the latter form of discretion normally have in mind administrative decision making without open hearings in which finely targeted, well-financed campaigns by specific industrial interests can have undue influence in favour of emergency protection. One could also lament the dampening effect on international trade that follows from unpredictable, discretionary procedures capable of shutting off arbitrarily an important market as soon as it becomes promising. Under the United States escape clause, however, executive discretion enters only after an open and formal finding of injury governed by reasonably objective standards.

[43] For Commerce's authority to accept an agreement and suspend the investigation, see 19 U.S.C. § 1671c (Supp. III 1979).

[44] 19 U.S.C. § 1677(5) (Supp. III 1979).

[45] See note 25.

[46] The Court of Customs and Patent Appeals recently struck down the Treasury's "trade distortion" test under the pre-1979 law. The case involved regional development grants in West Germany that benefited German float glass producers. See *ASG Industries, Inc.* v. *United States*, 610 F. 2d 770 (C.C.P.A. 1979), *reversing* 467 F. Supp. 1187 (Cust. Ct.).

[47] See *ASG Industries, Inc.* v. *United States*, 467 F. Supp. 1200, 1214 (Cust. Ct.), *rev'd on other grounds*, 610 F. 2d 770 (C.C.P.A. 1979) (describing Treasury test for defining "bounty or grant" in a domestic subsidy case).

[48] The closest the new law comes to the "trade distortion" concept is the requirement that a domestic subsidy be provided to a specific enterprise or industry. See 19 U.S.C. § 1677(5) (B) (Supp. III 1979). The act thus excludes general government benefits such as public education and public works.

[49] 19 U.S.C. § 1677(6) (Supp. III 1979). For clear evidence that Congress intended to narrow and restrict permissible offsets, see *Senate Report*, pp. 85-86; *House Report*, p. 74.

[50] *Senate Report*, p. 85. That Treasury had allowed such offsets in the past is evident in *ASG Industries, Inc.* v. *United States*, 610 F. 2d 770 (C.C.P.A. 1979).

[51] 19 U.S.C. § 1671b(a), (b) (Supp. III 1979). In "extraordinarily complicated cases," as defined by the statute, the deadline for the preliminary determination that a subsidy exists may be deferred 150 days. 19 U.S.C. § 1671b(c) (Supp. III 1979).

[52] 19 U.S.C. § 1671b(d) (Supp. III 1979). If the ITC determines that there is a reasonable basis to believe that "critical circumstances" exist, it may suspend liquidation retroactively on unliquidated items entered up to 90 days prior to the preliminary decision triggering the provisional remedy. Critical circumstances exist when the ITC finds a subsidy inconsistent with the Subsidies Code (presumably an export subsidy) and "massive imports" of the subsidized goods "over a relatively short period." 19 U.S.C. § 1671b(e) (1) (A)-(B) (Supp. III 1979).

[53] See Roy L. Prosterman, "Withholding of Appraisement Under the United States Anti-Dumping Act: Protectionism or Unfair-Competition Law?" *University of Washington Law Review* 41 (1966), pp. 318–19.

[54] 19 U.S.C. § 1516a (Supp. III 1979).

[55] The standard of review in the Customs Court for decisions taken later in the proceedings will be whether the decision is "unsupported by substantial evidence on the record, or otherwise not in accordance with law." 19 U.S.C. § 1516a(b) (1) (A) (Supp. III 1979). In challenges to various initial or preliminary decisions, when a formal record would not be well developed, the standard of review is whether the decision is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 19 U.S.C. § 1516a(b) (1) (A) (Supp. III 1979).

[56] 19 U.S.C. § 2253(h) (1), (2) (1976).

[57] *Ibid.*, § 2253(h) (3).

[58] 19 U.S.C. § 1675(b), (c) (Supp. III 1979).

[59] See Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970), p. 100. Dam cites a GATT Working Party report that states: "action under Article XIX is essentially of an emergency character and should be of limited duration."

[60] Although Article XIX does not speak specifically of an invoking country's obligation to encourage its domestic industry to make necessary adjustments to meet import competition, such an understanding seems implicit in an emergency remedy of limited duration. These notions are spelled out more clearly in the latest public version of the negotiating text for a Safeguard Code circulated in the Tokyo Round but not ultimately adopted. See GATT Secretariat Working Document MTN/SG/W 47 (11 April 1979) (Safeguards Code Negotiating Text). Chapter 3(b) of this document spells out an outer limit of five years for safeguard relief, and Chapter 3(d) obligates an invoking country to adopt "appropriate policy measures . . . to encourage the adjustment of domestic producers to import competition." The failure to reach agreement on a Safeguards Code related primarily to the issue of discriminatory relief (selectivity) and not to the requirements of temporariness and adjustment. See note 5.

[61] See, generally, Richard Blackhurst, Nicolas Marian, and Jan Tumlir, *Trade Liberalization, Protectionism, and Interdependence* (Geneva: GATT, 1977), pp. 43–60.

[62] *Ibid.*, pp. 21–42, generally.

[63] For a similar analysis applied to the rationale for adjustment assistance, see Malcolm D. Bale, "Adjustment Assistance: Dealing with Import-Displaced Workers," in Institute for Contemporary Studies, *Tariffs, Quotas & Trade: The Politics of Protectionism* (San Francisco: 1979), pp. 149–61. Perhaps the last point, political necessity, is more an explanation of why governments intervene than a rationale for it.

[64] For a more thorough analysis of this notion and a general discussion of the theoretical basis for protection against market disruption, see Gerald M. Meier, "Externality Law and Market Safeguards: Applications in the GATT Multilateral Trade Negotiations," *Harvard International Law Journal* 18 (Summer 1977), pp. 500–506.

[65] On the efficiency ground alone, without resort to equity and political considerations, one could not justify limiting government intervention to cases of economic injury caused by imports. At least not unless it could be shown that import injury is easier to isolate and less costly to remedy than the myriad domestic sources of business injury to

firms. See *Trade Policies Toward Developing Countries* (comment by I. Kravis) (Washington, D.C.: Bureau for Intragovernmental and International Affairs, Agency for International Development, 1978), pp. 154–55.

[66] For an example of careful application of the causation test that resulted in a negative decision, see note 37, *supra*. For a more general picture of the application of the American escape clause, see J. Jackson, *Legal Problems of International Economic Relations* (St. Paul: West Publishing, 1977), pp. 629–68. But see M. Morkre and D. Tarr, *The Effects of Restrictions on United States Imports* (Washington, D.C.: FTC Bureau of Economics Staff Report, 1980) concluding that recent restrictions on imports in five industries — textiles, sugar, non-rubber footwear, colour TVs, CB radios — yielded a net welfare loss to the country). The Morkre and Tarr study analysed primarily import restrictions and not other forms of intervention. In fact, the study's conclusion urges more reliance in the United States on adjustment assistance. *Ibid.*, p. 200. The problem of the proper form of intervention is discussed briefly in the text accompanying notes 71–72.

[67] See Blackhurst, Marian, and Tumlir, *op. cit.*, pp. 30–34. For an analysis of likely labour dislocation in the United States from the Tokyo Round tariff cuts, see J. Richardson, *The Impact of Multilateral Trade Liberalization on U.S. Labor*, report to the U.S. Senate Committee on Finance (MTN Studies 3) (Washington, D.C.: 1979).

[68] See text accompanying note 24.

[69] See notes 39 and 40 and accompanying text. Bale gives a slightly different equity argument. He notes that governments through tariff concessions cause injury and therefore could be said to owe some compensation (Bale, *op. cit.*, p. 155). This notion would be consistent with GATT Article XIX's requirement that GATT obligations or concessions be the cause of increased imports. The current U.S. safeguard law enacted in 1974, however, dropped that requirement, so that now any import surge, for whatever reason, may trigger safeguard relief. 19 U.S.C. § 2251 (1976 and Supp. III 1979). The discussion in the text is thus directed at this broader use of safeguards. Even here government concessions are probably at least an indirect cause of injury in all cases, since most import surges, even if they occur long after tariff reductions, would probably not have occurred were the original high tariff wall still in place. Without the tariff reductions there may never have been sufficient incentive for foreign entrepreneurs to seek to penetrate the American market.

[70] See discussion of exploitive purpose in Warren Schwartz, "The Social Costs of Intervention," in *Non-Tariff Barriers After the Tokyo Round*, edited by J. Quinn and P. Slayton (Montreal: The Institute for Research on Public Policy, 1982).

[71] See Blackhurst, Marian, and Tumlir, *op. cit.*, pp. 31, 41. See, generally, Harry G. Johnson, "Optimal Trade Intervention in the Presence of Domestic Distortions," in *Trade, Growth, and the Balance of Payments: Essays in Honor of Gottfried Haberler*, by Robert E. Baldwin *et al.* (Chicago: Rand McNally, 1965); Jagdish Bhagwati, *The Theory and Practice of Commercial Policy: Departures From Unified Exchange Rates*, Special Papers in International Economics No. 8 (Princeton, N.J.: Princeton University, Department of Economics, 1968), pp. 14–22; Geoffrey Denton, Seamus O'Cleireacain, and Sally Ash, *Trade Effects of Public Subsidies to Private Enterprise* (London: Macmillan for Trade Policy Research Centre, 1975), p. 10. Blackhurst, Marian and Tumlir also cite on this point (p. 41): Jagdish N. Bhagwati, "The Generalized Theory of Distortions and Welfare," in *Trade, Balance of Payments and Growth*, edited by J.N. Bhagwati *et al.* (Amsterdam: North-Holland, 1971); W.M. Corden, *Trade Policy and Economic Welfare* (Oxford: Oxford University Press, 1974); and "Review of Harry G. Johnson, *Technology and Economic Interdependence*," *Journal of World Trade Law* 10 (September-October 1976): 491–92.

[72] See John Barceló III, "Subsidies and Countervailing Duties — Analysis and a Proposal," *Law and Policy in International Business* 9 (1977), pp. 806–7 (discussing the special case of developing countries).

[73] See, for example, *Senate Report*, p. 37; and Harold B. Malmgrem, *International Order for Public Subsidies* (London: Trade Policy Research Centre, 1977), p. 28.

[74] See, for example, W. Walker, International Limits to Government Intervention in the Market-Place (London: Trade Policy Research Centre, 1976), pp. 10–11; Kenneth D. Walters and R. Joseph Monsen, "State-Owned Business Abroad: New Competitive Threat," *Harvard Business Review* 57 (March-April 1979), pp. 164–67. See also *Multilateral Trade Negotiations, Hearings Before the Subcommittee on Trade of the House Committee on Ways and Means*, 96th Cong., 1st sess. (1979), pp. 31–33 (statement of the Ad Hoc Subsidies Coalition).

[75] For a more thorough discussion of the uncertain efficiency effects of domestic subsidies, see Barceló, "Subsidies and Countervailing Duties," pp. 837–38.

[76] Non-economic goals or public goods (sometimes called collective goods) are those goods desired or demanded by the nation as a whole but unachievable (for free-rider and other reasons) through the private market. See, generally, Charles P. Kindleberger, *Government and International Trade*, Essays in International Finance No. 129 (Princeton, N.J.: Princeton University, Department of Economics, 1978).

[77] See, for example, letter to editor from E. March, Chairman Advisory Committee, Specialty Steel Industry of the United States, *New York Times* 22, col. 1 (8 November, 1980); and note 74.

[78] For a similar argument supporting the view that countervailing duties are without justification, see Schwartz, "Zenith Radio Corp. v. United States: Countervailing Duties and the Regulation of International Trade," 1978 *Sup. Ct. Rev.*, pp. 304–12.

[79] See Cooper, "The Nexus Among Foreign Trade, Investment, and Balance-of-Payments Adjustment," II *United States International Economic Policy in an Interdependent World: Report to the President*, Vol. 2, pp. 522–23 (U.S. Commission on International Trade and Investment Policy) (Washington, D.C.: Government Printing Office, 1971).

[80] See 19 U.S.C. § 1677(5) (B) (Supp. III 1979).

[81] An additional and similar effect derives from the trade sector interference caused by a countervailing duty. This sacrifices more in American national welfare for an equivalent amount of benefit to American producers than would a straightforward subsidy to American producers financed from general tax revenues. See note 71.

[82] The next section on the Track II approach to subsidies will discuss equity considerations at the government-to-government level.

[83] For a more thorough development of this point, see Barceló, "Subsidies and Countervailing Duties," pp. 794–99. That article discussed several exceptions to the general rule that export subsidies are distortive and should be prohibited. *Ibid.*, pp. 801–23.

[84] The dual price pattern presupposes regulations prohibiting the immediate re-import of subsidized shoes. Without such regulations, of course, the subsidy would not long remain limited to exported items.

[85] Political, fiscal, and administrative reasons may support the use of an export instead of domestic subsidy when a country seeks a non-economic internal goal. It may be politically possible to enact an export subsidy, but not a domestic subsidy. This argument is weak, however, since fiscal and administrative factors appear roughly equivalent when choosing between applying a given government expenditure to all production, or only to that production exported.

[86] See, generally, note 71.

[87] *Ibid*.

[88] See note 10.

[89] The prior rule still applies to GATT signatories who are not signatories of the Subsidies Code. See GATT Article XVI (B) (4).

[90] Subsidies Code, Annex. This list contains — with some additions, clarifications and minor changes — all the items on the 1960 GATT Working Party list generally understood to have been prohibited by GATT Article XVI (B) (4). See BISD (9th Supp.) 185–87 (1961). The new list contains the following prohibitions:

(a) Direct subsidies to firms contingent on export performance.
(b) Currency retention schemes involving a bonus on exports.
(c) Government provided or mandated internal transport charges for export shipments on terms more favorable than for domestic shipments.
(d) Delivery by government of goods or services for production of exported goods on terms more favorable than for domestic goods and than commercially available.
(e) On exports, rebate or deferral of direct taxes or social welfare charges.
(f) Allowance of special deductions directly related to exports in calculating direct taxes.
(g) On exports, rebate of indirect taxes in excess of those levied on goods consumed domestically.
(h) On exports, rebate or deferral of prior stage cumulative indirect taxes, unless levied on goods physically incorporated in the exported product (not applicable to value-added-tax, which may be rebated under (g) above, see Code, Annex, note 3).
(i) Drawback of import duties in excess of those levied on imported goods physically incorported in the exported product.
(j) Government export credit or guarantees against cost increases or exchange risk at rates inadequate to cover long-term operating costs of the program.
(k) Government export credit at rates below the cost of funds employed, unless consistent with an international undertaking on export credits to which 12 of the original signatories of the Code are parties.
(l) Any other charge on the public account constituting an export subsidy under GATT Article XVI.

[91] Compare Subsidies Code Article 10, with GATT Article XVI (b) (3).

[92] The Subsidies Code expressly approves the following objectives of subsidy programmes: aid to disadvantaged regions; decentralization of industry; adjustment assistance to ailing sectors; encouragement of research and development; implementation of development plans by developing countries; and sustaining employment and encouraging employment programmes. Subsidies Code Article 11(1)

[93] *Ibid.*, Article 11(2).

[94] *Ibid.*, Article 12.

[95] *Ibid.*, Article 13.

[96] *Ibid.*, Article 18.

[97] See Articles 13(1), 17, and 18 (6 months for an export subsidy case); Articles 13(2), 17, and 18 (7 months for a domestic subsidy case).

[98] Although Subsidies Code Article 8, note 4 provides that a presumption "may" arise, Subsidies Code Articles 12(1) and 13(4) plainly imply that the complaining government has no burden of showing adverse effects, if the opposing government has used an export subsidy. See also Subsidies Code Article 11(4) ("There shall be no presumption that export subsidies granted by *developing* country signatories result in adverse effects . . . ") (emphasis added).

[99] Subsidies Code Article 8 note 4.

[100] *Ibid.*, Articles 13(4), 17, and 18. Since the Committee must consider "the nature and degree of the adverse effect found to exist" before authorizing "appropriate countermeasures," Subsidies Code Articles 18(9), 13(4), a complaining government might have to introduce some evidence of adverse effects before the Committee will authorize retaliation.

[101] Subsidies Code Articles 12(3)−(4), 8(3)−(4).

[102] 19 U.S.C. § 2411 (1976), as amended by the Trade Agreements Act of 1979, § 901, 19 U.S.C. § 2411 (Supp. III 1979). For a general discussion of trade retaliation under section 301 of the Trade Act of 1974 before the 1979 act changes, and of the relationship of the prior law to GATT, see Robert E. Hudec, "Retaliation Against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment," *Minnesota Law Review* 59 (1975): 461−539.

[103] See Executive Order No. 12,188, 45 *Federal Register* 989 (1980).

[104] 19 U.S.C. §§ 2412-2413 (Supp. III 1979). For the Trade Representative's new regulations under amended section 301, see 45 *Federal Register* 34, 870 (1980) (to be codified in 15 C.F.R. pt. 2006).

[105] 19 U.S.C. § 2414 (Supp. III 1979).

[106] Compare 19 U.S.C. § 2414(a) (1) (A) (Supp. III 1979) (allowing 7 months for the Trade Representative's recommendation in a case involving an export subsidy prohibited by the Subsidies Code) with Subsidies Code Articles 13(1), 17, and 18 (allowing 180 days from preliminary request for consultation to final Committee recommendation); and compare 19 U.S.C. § 2414(a) (1) (B) (Supp. III 1979) (allowing 8 months for the Trade Representative's recommendation in a case involving a domestic subsidy) with Subsidies Code Articles 13(2), 17, and 18 (allowing 210 days).

[107] 19 U.S.C. § 2411(c) (2) (Supp. III 1979).

[108] See 19 U.S.C. § 2412(a) (Supp. III 1979) (45 days for Trade Representative to decide whether to initiate investigation); 19 U.S.C. § 2414(a) (1) (A) (Supp. III 1979) (7 months for recommendation of the Trade Representative); 19 U.S.C. § 2411(c) (2) (Supp. III 1979) (21 days for President's decision).

[109] See *ibid*., except that in a domestic subsidy case 19 U.S.C. § 2414(a) (1) (B) (Supp. III 1979) allows 8 months for the recommendation of the Trade Representative.

[110] 19 U.S.C. § 2411 (Supp. III 1979). The President may act under any existing authority, for example, that granted in § 125 of the Trade Act of 1974, 19 U.S.C. § 2135 (1976), or under the express grant of retaliatory authority in the 1979 act. See 19 U.S.C. § 2411(b) (Supp. III 1979).

[111] Subsidies Code Article 19(1).

[112] Subsidies Code Articles 18(9) and 13(4).

[113] The importing country of course stands to lose the benefit of the cheap subsidized goods, but it stands to gain the benefits of similar protection against displacement of its own exports and the long-run welfare benefits of a more efficient global economy. These benefits will not so unambiguously outweigh the immediate benefits of cheap imports that an importing country could be expected always, or even frequently, to oppose other-country export subsidies. Indeed, the analysis in the text at notes 83–87 concluded that only protectionist motives could explain such opposition to bounty-fed imports on any grounds more restrictive than those governing safeguard relief.

[114] See Hudec, *op. cit.*, pp. 483–90. A GATT Working Party report adopted by the Contracting Parties contains the following language:

> The Working Party considered many proposals for strengthening the present provisions of the Agreement with respect to the use of subsidies. So far as domestic subsidies are concerned, it was agreed that a contracting party which has negotiated a concession under Article II may be assumed, for the purpose of Article XXIII, to have a reasonable expectation, failing evidence to the contrary, that the value of the concession will not be nullified or impaired by the contracting party which granted the concession by the subsequent introduction or increase of a domestic subsidy on the product concerned. (BISD (3d Supp.) 224 (1955)).

The code in a footnote seems obliquely to refer to this understanding. See Subsidies Code Article 8(3) (b), note 2. The current GATT understanding seems to apply only to a subsidy granted directly on the product in question, not one on a competing product that indirectly undercuts imports. It is not clear how far the concept of a subsidy "on the product" will reach. There is no authoritative GATT discussion of whether it applies to a general subsidy on research and development or a regional subsidy that directly aids shoe firms. If the touchstone here is the justified expectations stemming from a tariff concession, plainly an agreement to bind a tariff on shoes is not an agreement foreclosing all domestic measures that may operate indirectly to reduce shoe imports.

[115] See Hudec, *op. cit.*, p. 484, note 65.

[116] *Ibid.*, pp. 483–500, 505.

[117] For a study suggesting the difficulty of reaching any strong conclusions about the trade effects of domestic subsidies, see Denton, O'Cleireacain, and Ash, *op. cit.*, pp. 75–95.

[118] Subsidies Code Article 11(2) (emphasis added).

[119] See Hudec, *op. cit.*, pp. 482–500. As of 1975, the GATT had never authorized retaliation in a non-violation nullification or impairment case. *Ibid.*, p. 505. This writer has found no cases doing so since then. But this seems mostly because all contentious cases have been settled after the GATT announced its finding of nullification or impairment. *Ibid.*, pp. 485–92.

[120] *Ibid.*, pp. 483–85.

[121] See Subsidies Code Preamble.

[122] Subsidies Code Article 8(4) (footnotes omitted). The distinction between "displacing or impeding" in the subsidizing country's market and merely "displacing" in third-country markets seems significant. Presumably a complainant could seek redress for loss of an expected increase in exports to the subsidizing country itself, but not to a third country. A footnote to the code explaining the term "displacing" in the third-country-market case reinforces this view:

> The term 'displacing' shall be interpreted in a manner which takes into account the trade and development needs of developing countries and in this connection is not intended to fix traditional market shares.

Article 8(4) note 1. Hence, developing countries alone may be allowed to argue loss of an expected increase in export volume to a third country.

[123] See, generally, Commission of the European Communities, *First Report on Competition Policy* (1972); *Second Report* (1973); *Third Report* (1974); *Fourth Report* (1975); *Fifth Report* (1976); *Sixth Report* (1977); *Seventh Report* (1978); and *Eighth Report* (1979).

[124] See "Chrysler Aid: Thorny Issue," *N.Y. Times* 1 (2 August 1979).

[125] See 45 *Federal Register* 66833 (1980) (reinstatement of trigger price mechanism for steel).

The Amended Anti-dumping Code and The Trade Agreements Act of 1979

7

by
Stanley D. Metzger

The Multilateral Trade Negotiations (MTN), begun in Tokyo in 1973 and concluded in Geneva in 1979, resulted in additional tariff reductions[1] and a variety of agreements and codes in the non-tariff trade area: from government procurement, product standards, civil aircraft, wine gallon duty assessment, bovine meat, cheese, and custom valuation, to subsidies and countervailing duties and anti-dumping measures. It is much too early to essay a definitive overall conclusion concerning the effects of the MTN, though it appears safe to view the potential economic impact "with considerable scepticism."[2] In its report on legislation implementing the various agreements, the Ways and Means Committee of the U.S. House of Representatives considered that the "measurable impact of the tariff negotiations will be minimal," ranging as they do from 2.0 percentage points for Japan, 2.5 for the United States and the European Communities, to 4.4 for Canada, to be phased in generally over a period of eight years. According to the Committee, this "pales in an age of worldwide inflation" and rapid technological change. Moreover, tariff reductions were "avoided in many highly import-sensitive lines," and "minimal tariff reductions were made in highly import-sensitive sectors."[3]

So far as the non-tariff negotiations are concerned, the Ways and Means Committee also expressed a very reserved opinion. The "very nature of the subject matter," said the Committee, does not lend itself to economic models or quantification, but rather "to a qualitative assessment." Even more than in the case of tariff reductions, the "state of knowledge about the impact of trade on jobs and consumer costs, let alone the absence of recent and disaggregated data . . . and the questionable validity of economic assumptions that have to be made with respect to elasticity of supply and demand" make any forecasts of the possible impact of the various codes and agreements, which are not quantifiable, of "highly questionable reliability."[4]

One agreement of the group that resulted from the MTN — the Amended Anti-dumping Code — and its implementation lends itself to a more assertive appraisal. For whatever the verdict may be as to the rest of the MTN's results — if indeed any verdict will ever be made —

the Amended Anti-dumping Code and its implementation must be judged a major backward step toward the very protectionism that the MTN was designed to prevent. The remainder of this essay will seek to demonstrate the validity of that thesis.

1. Background of the Amended Anti-dumping Code of 1979

The Amended Anti-dumping Code of 1979 cannot be understood or evaluated without considering its origin — the forces that led to its negotiation and that illuminate its provisions. Article VI of the GATT had laid down the principle that dumping — selling overseas at less than normal value (usually the home market price) — is to be condemned if it causes or threatens injury to an established industry or materially retards development of an industry. In so stating the principle, the GATT was adopting a "tariff" approach, rather than an "antitrust" approach, to price discrimination. Typical American legal and economic theory surrounding the area of economic regulation of business enterprises is based on "a commitment to a competitive system which is premised to allocate resources most efficiently and to result in the distribution of goods to the consumer at the lowest possible price."[5] A tariff approach that couples price discrimination between national markets with an exclusive emphasis upon injury to domestic firms does not promote competition and enhance consumer satisfaction.[6] When a tariff standard is used, the fact that dumping can result in real advantages to consumers and to society as a whole, far outweighing the loss of sales or profits to some domestic firms, is overlooked or simply ignored.[7]

As an example, let us suppose that the product market is dominated by a domestic monopoly or oligopoly. The entry of goods sold at less than their home market price in appreciable quantity can force the monopolist or oligopolist to lower his prices to a competitive level, or can weaken his position, reducing barriers to competing domestic firms. Although in either case the result would be lower prices and increased quality competition, the "injury" to the concentrated industry would be practically certain, under a tariff standard, to satisfy anti-dumping duty requirements.[8] Or suppose that the imported product is a raw material or semi-finished product. Availability of such materials at low prices enables smaller firms producing finished products to compete more successfully with larger and integrated firms controlling the domestic source of supply, and is highly likely to result in lower prices to all consumers. These are not theoretical examples, but are quite common. When I served as chairman of the U.S. Tariff Commission some twelve years ago, the two anti-dumping cases we had tracked each of these examples —

Titanium Sponge from the U.S.S.R.,[9] and Pig Iron from East Germany, Czechoslovakia, Romania, and the U.S.S.R.[10]

A test based on anti-competitive effect would not ask whether dumped imports resulted in loss of sales, lowered prices, and reduced profits to domestic competitors, but whether the imports constituted a threat to the continuation of viable competition in the relevant market. It would assume that whenever possible the domestic firms would, by increasing productive efficiency, meet lower prices while refraining from domestic price-fixing practices, rather than avoid price competition by invoking anti-dumping remedies to exclude the imports.[11]

Unfortunately, while it is sometimes argued that the legislative history of the U.S. Anti-dumping Act of 1921 is ambiguous on this score,[12] there is little doubt that the weight of that history, as well as the experience under the 1921 act and its successors, demonstrates that the tariff approach is the approach of the U.S. law. The same is true of other countries with anti-dumping legislation; in some cases such as Canada and South Africa, that legislation antedated the U.S. law.[13]

The U.S. 1921 act did include an injury test, but it was general and vague. An administrative tribunal (first the Treasury, then the Tariff Commission, later renamed the International Trade Commission) was to determine within three months from the time that the Treasury Department (now the Commerce Department) found that "dumping" had occurred, "whether an industry in the United States is being or is likely to be injured, or is prevented from being established, by reason of" the dumped imports. No guidance was given in the text of the law on the key questions: the degree of injury, the degree of causation required before it could be held that such injury was "by reason of" the dumped imports, or the factors to look to in order to determine whether "an industry" was being injured. Nor was "an industry" defined. The committee reports were of no help. The only help was what the act's sponsors said during the 1921 Senate floor debate on the bill, where the "injury" requirement was added. The sponsor in the Senate, Senator McCumber (of the Fordney-McCumber Tariff Act), said that the law was aimed at purposeful predatory dumping, and a principal supporter, Senator Watson, said that it was aimed at dumped imports which, though not predatory in intention, had the effect of "destroying" an American industry.[14] But those intentions were not reflected in the language of the law, and did not find their way into any committee or conference report on the act. I believe that the act at least intended that the degree of injury must be substantial and that an "analysis of all the factors affecting the health and well-being" of an industry must be explored in order to assess whether the injury was as serious as the Senators had in mind.[15]

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Unfortunately, while it is sometimes argued that the legislative history of the U.S. Anti-dumping Act of 1921 is ambiguous on this score,[12] there is little doubt that the weight of that history, as well as the experience under the 1921 act and its successors, demonstrates that the tariff approach is the approach of the U.S. law. The same is true of other countries with anti-dumping legislation; in some cases such as Canada and South Africa, that legislation antedated the U.S. law.[13]

The U.S. 1921 act did include an injury test, but it was general and vague. An administrative tribunal (first the Treasury, then the Tariff Commission, later renamed the International Trade Commission) was to determine within three months from the time that the Treasury Department (now the Commerce Department) found that "dumping" had occurred, "whether an industry in the United States is being or is likely to be injured, or is prevented from being established, by reason of" the dumped imports. No guidance was given in the text of the law on the key questions: the degree of injury, the degree of causation required before it could be held that such injury was "by reason of" the dumped imports, or the factors to look to in order to determine whether "an industry" was being injured. Nor was "an industry" defined. The committee reports were of no help. The only help was what the act's sponsors said during the 1921 Senate floor debate on the bill, where the "injury" requirement was added. The sponsor in the Senate, Senator McCumber (of the Fordney-McCumber Tariff Act), said that the law was aimed at purposeful predatory dumping, and a principal supporter, Senator Watson, said that it was aimed at dumped imports which, though not predatory in intention, had the effect of "destroying" an American industry.[14] But those intentions were not reflected in the language of the law, and did not find their way into any committee or conference report on the act. I believe that the act at least intended that the degree of injury must be substantial and that an "analysis of all the factors affecting the health and well-being" of an industry must be explored in order to assess whether the injury was as serious as the Senators had in mind.[15]

Most of the law's administrators from 1921 on, as well as the congressional committees that in recent years either had a legitimate opportunity to put a gloss on the act's language or went out of their way to seize an opportunity to do so, appeared to pay no attention to the statements by the act's senatorial sponsors, if indeed they were even aware of those statements. It was no wonder, then, that successive Tariff commissioners took widely differing positions on these questions in their application of the statute, depending in no small part on whether they leaned toward the free trade or protectionist persuasion. Since protectionists have always been in a majority on the Commission, it is no accident that there have been many cases where injury has been found that was not "material" or substantial and where causation was quite insubstantial. Trading partners of the United States, particularly European countries, became very concerned, and pressed their reforming efforts at the Kennedy Round negotiations from 1963 to 1967. While the French may have raised the U.S. anti-dumping practices in order to bargain for more moderate reductions in the Common External Tariff than were being sought by the United States,[16] others, particularly Britain, were concerned with substance, wholly apart from negotiating tactics. The International Anti-dumping Code[17] was negotiated as part of the Kennedy Round agreements. The code was designed to stiffen the requirements of Article VI of the GATT, which, like the U.S. 1921 act, had left undefined all the critical questions -- degree of injury (apart from stating it must be "material"), quantity and quality of causation, the definition of injury itself, and of "industry."

Code Article 3 required that a determination of injury could be made "only when" the authorities were "satisfied that the dumped imports are *demonstrably the principal cause*" (emphasis added) of material injury or retardation of establishment of domestic industry. In reaching their decision, the local authorities were to "weigh, on the one hand, the effect of the dumping and, on the other hand, all other factors taken together which may be adversely affecting the industry." The determination was to be based upon "positive findings and not on mere allegations or hypothetical possibilities." In cases of "threat" of injury, the determination was to be based on "facts and not merely on allegation, conjecture or remote possibility"; the threat was to be "clearly foreseen and imminent." In determining whether "material" injury had occurred, certain criteria for judgement were prescribed. "All factors" having a bearing on "the state of the industry" had to be examined, such as:

> . . . development and prospects with regard to turnover, market share, profits, prices (including the extent to which the delivered, duty-paid price is lower or higher than the comparable price for the like product prevailing in the course of normal commercial transac-

> tions in the importing country), export performance, employment, volume of dumped and other imports, utilization of capacity of domestic industry, and productivity.

The code admonished that "no one or several of these factors" can necessarily give decisive guidance.

Code Article 4 required that the "domestic industry" injured was to be interpreted as referring to "domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of domestic production," save in two exceptional circumstances. First, when domestic producers were importers of the dumped product, the industry could be interpreted to refer to the rest of the producers. Secondly, a country could be divided into two or more competitive markets if, because of transport costs or other special regional marketing conditions, there was a high degree of isolation of producers in such a market from the rest of the industry, provided that even in those circumstances there was injury to "all or almost all of the total production of the product in question."

It is obvious from these provisions that while retaining the GATT's "tariff approach" to dumping, the code's drafters wished to tighten and make much more difficult dumping injury findings so that in the future they would not become a formidable barrier to international trade, rivalling the quotas and high tariffs that it was the purpose of the GATT to eliminate and reduce.

The 1967 code was not "self-executing"; it had to be translated into the domestic law of the various signatories by domestic legislation, in those countries whose existing legislation was inconsistent with code provisions.

In the United States, the administration took the position that no legislation was necessary. There was nothing in the code contrary to the 1921 act. Thus, for years the administrators of the act, the Treasury Department and the Tariff Commission, had interpreted "injury" to mean "material" injury. Again, there was nothing in the statute's causation requirement, "by reason of," which prevented the Commission from reading it to mean "demonstrably the principal cause" of injury. Indeed, one reading of "by reason of," not foreclosed by the act or by its legislative history, could have been "demonstrably the only cause," and another could have been "demonstrably the overwhelming cause." There was nothing in the code's "regional market" segmentation provision at odds with the statute's "definition" of "industry," or indeed with what the Commission had done administratively to accommodate the "isolated" segment injured by dumped imports. Other relatively minor provisions of the code, such as the requirement for consideration of injury at the time the dumping question was investigated (designed to forestall lengthy investigations into "dumping," with consequent withholding of appraisement, to be followed much later by investigation of the injury question), while different from the existing practice, were able to be accommodated by regulation to avoid conflict.

The administration did not prevail, however, in the face of a campaign by the U.S. cement and steel industries. Those industries recognized that the code's more stringent injury requirements would impede their ability to secure injury determinations. They were aided and abetted by some leading Senators, including the then — and present — chairman of the Senate Finance Committee, the committee with jurisdiction over anti-dumping matters.[18] As a result of those efforts to overturn the code, an amendment to the 1921 act was enacted providing that "nothing contained in" the code "shall be construed to restrict the discretion of the United States Tariff Commission in performing its duties" under the act, and, in particular, the Commission "shall resolve any conflict between" the code and the act "in favor of the Act as applied by" the Commission, and "shall take into account" the provisions of the code "only insofar as they are consistent with" the act "applied by" the Commission.[19] This meant that Tariff commissioners would be free to continue to interpret and apply the act in a much looser manner than the code permitted — both as to quantum of injury and degree of causation. A few commissioners took the position that anything more than trifling injury (a so-called *de minimis* test) caused even in small part "by reason of" dumped imports, spelled anti-dumping duties. This was what the protectionists wanted, and the amendment permitted commissioners so minded to continue to apply that kind of gloss to the 1921 act.[20]

This congressional treatment of the 1967 code was a clear signal to its administrators, particularly the Tariff Commission, that the code should be subordinated to the 1921 act, if not ignored.

Underlining its antagonism toward the code, six years later, in the legislative report accompanying the Trade Act of 1974, which provided the fresh tariff-cutting authority and ground rules for the MTN, the Senate Finance Committee went out of its way to disavow specifically the principal substantive reforms of the 1967 code.[21] The Senate Committee report's views on quantum of injury and degree of causation did not constitute "legislative history" binding on agencies because the 1974 act did not change the injury or causation provisions of the 1921 act, nor was there a counterpart of the report's views on injury in the House Ways and Means Committee's report on the 1974 Trade Act, in the conference report, or in floor debates in either house. It is thus clear that the report's views constituted neither new law nor even congressional statutory construction of the 1921 act. Nonetheless, the report was intended to and did profoundly influence the injury determinations made through 1979. The International Trade commissioners are appointed subject to the "advice and consent" of the

Senate, and this means consent of the Senate Finance Committee. The Commission must secure annual appropriations. The Commission is viewed as a "congressional" agency — its origins lay in the need of Congress to have available "expert" assistance to it in formulating tariff legislation. It was to be expected that the Commission would march to the report's tune in deciding cases.[22] Not a single commissioner from 1974 through 1979 failed to follow dutifully the report's non-binding views on injury. The rate at which the Commission found injury increased from the 10.0 to 20.0 per cent range of cases initiated by Treasury in 1972–74 to 30.8 and 42.9 per cent in 1976 and 1977 respectively.[23]

The report's views on injury were that the 1921 act was "primarily concerned with the situation in which the margin of dumping contributes to underselling the United States product in the domestic market," resulting in injury or likelihood of injury to a domestic industry. Dumped goods that undersell domestic products are to be found to cause injury, judged by such indicators as "suppression or depression of prices, loss of customers, and penetration of the United States market." Injury under the 1921 act being unqualified by adjectives such as "material" or "serious," it excludes only "trifling, immaterial, insignificant or inconsequential" injury. As an example of "immaterial injury," just to make sure that none would lose the point, the report mentioned "spiritual injury, which may exist inside of persons not industries."[24]

On causation, the report specifically disavowed the 1967 code. The 1921 act "does not contemplate that injury from less-than-fair value imports be weighed against other factors which may be contributing to injury to an industry."[25] While the words "by reason of" express a causation link, they "do not mean that dumped imports must be a (or the) principal cause, or a (or the) substantial cause of injury caused by all factors contributing to overall injury to an industry." Injury "caused by unfair competition," the report stated, does not require "as strong a causation link as would be required for determining the existence of injury under fair trade conditions."[26]

A word is in order about the "unfair competition" language of the report. Selling in one market below cost or below prices in another market, whether in the form of loss leaders, January "white sales," discount drug and radio stores, or automobile rebates to move end-of-the-line goods, is normally thought of as an effort to compete, to the benefit of consumers, the seller, and society. It is not usually referred to by the pejorative phrase "unfair competition," unless its purpose is anti-competitive. The extent to which these business practices result in price depression and loss of customers to the non-vigorous competitor, with consequent lower profits to him, normally signifies a successful sales campaign. Indeed, such practices are thought to be the essence of true competitive behaviour, as Mr. Lee Iacocca proclaims when he says that Chrysler is "now doing business as Detroit hasn't done it before." To label practices "unfair," when employed in international trade, when they are deemed beneficial in a competitive domestic economy, appears to be either pure chauvinism or mercantilism. To administer anti-dumping laws to protect domestic industry from territorial differential pricing practices that are greeted enthusiastically when engaged in at home, is to turn them into engines of protectionism.

During the twelve years from 1967 to 1979, the Tariff Commission and its successor, the ITC, ignored the 1967 code. Its anti-dumping determinations, various and inconsistent as ever, were at best of a piece with those that had led to the effort to negotiate the 1967 code. In a study of all the positive determinations during a representative two-year period, 1974–75, I found that in none were the code's requirements followed, and that in all of them, abiding by codal requirements would have resulted in negative determinations.[27] A study of the positive determinations between 1975 and 1980 would doubtless disclose more of the same.

The fate of the 1967 code in the United States was not lost on other countries. Canada, in enacting its new anti-dumping law, which for the first time had to include an injury test, refused to adopt the crucial codal requirement that dumped imports be "demonstrably the principal cause" of injury. Having witnessed the U.S. Congress' treatment of the code in 1968 and being concerned that the code's standard was too stiff, Canada opted for the vague and soft requirement of "having caused, is causing or is likely to cause material injury" to production in Canada of goods like the imported product.[28] The Canadian Anti-dumping Tribunal's adjudications of injury disclosed results similar to those of its American counterparts. During 1974–75, six affirmative injury findings were made that would not have passed muster had the codal requirements been applied.[29] These were quite representative of the period 1969–74, and 1975–79 as well.[30]

2. The Negotiation of the Amended Anti-dumping Code of 1979

During the 1970s, trading partners of the United States, the European countries, Japan, and the developing countries examined periodically the performance of GATT countries in implementing the 1967 code. There the failure of the United States, among others, to conform with code requirements was regularly raised, but since very little could be done in the face of domestic laws and their implementation, nothing much happened except the voicing of dissatisfaction. The GATT Council in 1970 did establish a Working Party on the Acceptance of the 1967 code to examine the special problems developing countries had with the code; the code had been accepted by some twenty-six countries, but this number included only two developing countries (Malta and Yugoslavia) that were members of the "Group of 77."[31] Many developed countries were unhappy with the code because some of the leading developed countries, such as the United States, were not complying with it. Developing countries were unhappy for this reason too, but also because for them it was a way of life to sell in export markets for prices lower than those which "for various reasons" prevailed in their domestic markets. The principal reason for their higher domestic price is, of course, the domestic monopoly or oligopoly (mostly the former) producing for a limited home market amply protected by tariffs and/or quotas from import competition. As an UNCTAD study explained, to "find outlets for their manufactures," developing countries "were compelled to sell at international prices" which thus "could be termed" dumped, despite the fact that the "classic motives for dumping," such as to gain "an unfair share of markets by eliminating competitors," did not exist. While developed countries' representatives "continually expressed understanding of the problems" thus raised, nothing could be worked out because of existing law in developed countries.[32]

As the MTN approached, the developing countries drew up an agenda for revision of the 1967 code, aimed at strengthening the code's reforms, including the stricter definition of causality, which had proved too much for the United States and Canada to swallow. Developing countries wanted to see strict causality applied by developed countries ("demonstrably the principal cause"). They also desired "special and more favourable" treatment for LDC's (less developed countries), and disregard of the home market price of LDC exports in favour of the "comparable price of the like product exported to third countries." They secured no satisfaction in the Group on Non-Tariff Measures.

Meanwhile, the developing countries became badly trapped. One of their major objectives (and of a number of developed countries as well) was the injection of an injury requirement into the United States' countervailing duty law. The U.S. statute[33] required added duties to offset bounties or grants in the production or export of import dutiable articles regardless of any injury to domestic industry, like the counterpart Canadian 1921 anti-dumping law. Both were protected from "violation" of Article VI of the GATT by virtue of the GATT Protocol of Provisional Application, which grandfathered mandatory existing legislation in signatory countries of the GATT. Since many, if not all, developing countries subsidize in one form or other most of their important export products, including raw materials, they were at continual risk of being countervailed in one of their most important markets — the United States — especially since Congress in the Trade

Act of 1974 had mandated Treasury Department action in countervailing duty complaint cases within short time limits. Until 1974, the Treasury could put a slow man to work on such cases, which were less than fully welcomed by administrators devoted to expanding trade, including imports. In consequence, developing countries were most interested, along with developed countries, many of whose exports were also at great risk (particularly agricultural products), in negotiating a Subsidies and Countervailing Duties Code that would require countries, including the United States, to impose an injury requirement before countervailing duties could be levied.

Accordingly, a Subsidies and Countervailing Duties Code (CV Code) was negotiated in the MTN. There was little chance that stricter injury provisions could be negotiated in a CV Code that for the first time mandated an injury requirement for all signatories, than had resulted from the legislative crucibles in the United States and Canada on the 1967 Anti-dumping Code. Yet the developing countries had too much at stake by way of exports to avoid accepting a weak injury test; the alternative was none at all. Once the CV Code was negotiated, with its weak injury requirement, it was almost impossible for negotiators to avoid making conforming changes in an Amended Anti-dumping Code, weakening the injury requirements of the 1967 code. In the circumstances of 1979 (high unemployment and rising protectionism), it was unrealistic to expect countries that had earlier refused to adopt the stricter requirements of the 1967 code to seek domestic law changes in order to do so.

As UNCTAD analysed it after the conclusion of the MTN, "the weakening of the injury concept" in both countervailing and anti-dumping was the "price that had to be paid to obtain the incorporation of any injury criterion" into U.S. countervailing duty law. While the latter was an "important concession for many countries, including developing countries," it must be "taken as a demonstration of the rising protectionist trend in developed countries." The major trading partners of the United States, who had earlier pressed for a stricter injury test under Article VI — that is, the 1967 Code — had "now not only accepted that the United States apply a much weaker version of what had been their previous interpretation of Article VI in more liberal times," but after the Amended Code of 1979 modified their own legislation to apply the "revised" criteria themselves.

3. The Principal Provisions of the Amended Code of 1979

The MTN's Amended Anti-dumping Code of 1979[34] marked a major retreat from the 1967 code, as it in effect ratified the 1970s anti-dumping practices of the United States, Canada, and some other countries. On the crucial injury determination question, the new code's Article 3 (4) deliberately omits the "demonstrably the principal cause" formula of the 1967 code, and the requirement that the various possible contributing causes of injury be weighed. It merely states that "it must be demonstrated that the dumped imports are, through the effects of dumping, causing injury within the meaning of the Code." While there may be "other factors" that are at the same time injuring the industry, and while these injuries "must not be attributed to the dumped imports," the refusal to provide for weighing was a clear genuflection to the Senate Committee report of 1974. "Material" injury was left undefined.

The provisions of Article 3 (2) concerning the volume of dumped imports require that investigating authorities consider whether there has been a "significant increase" in dumped imports, either in absolute terms or "relative to production or consumption in the importing country." So far as the "effects" of dumping on prices are concerned, the questions to be considered are "whether there has been a significant price undercutting" or whether "the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree." The code also calls for an examination of the impact on the domestic industry of all relevant economic factors having a bearing on the state of the industry, in this respect tracking the 1967 code.

It can be seen from these provisions that the negotiations resulted in major changes in the 1967 code's formulations on injury so as to bring them into conformity with practices of the American and Canadian tribunals. In the U.S. case, the Amended Code amounts to an acceptance of the Senate Committee's 1974 formulations, which were deliberately designed to reject the 1967 code in favour of looser criteria for the imposition of anti-dumping duties. The concept of regional markets was also revised to make somewhat easier the segmentation of industry for injury purposes, but by all odds the key change was emphasis on softer causation and softer injury requirements. The Amended Code's injury requirements are so general and vague that when translated into domestic law in the United States, like the 1921 act, they continue to enable a Commission that always ignored the 1967 code to make injury determinations in an "intuitive, largely subjective" manner, to use the revealing phrase of the Commission's chairman.[35]

4. The Trade Agreements Act of 1979

The Trade Act tracks the Amended Code's treatment of material injury "by reason of" dumped imports. This formulation of injury and causation allows the widest flexibility to find that dumped imports have resulted in material injury even where they may have contributed thereto only in small degree. Under this formulation, the Commission may be expected to continue making affirmative findings when there is a congruence of underpricing, testimony by a handful of customers that they bought the lower-priced imports rather than the higher-priced domestic product, and decreased profitability of domestic industry.

The trading partners of the United States fought hard to secure insertion of the word "material" in both the 1979 Countervailing and Anti-dumping Codes. The word sounds much more substantial than the bare word "injury," which is capable of being read, by those whose interests so require, as "even a tiny injury." And the American negotiator insisted that an uneasy Congress agree to the insertion of the magic word "material" in the 1979 act.

But how much of a safeguard against old abuses is the new adjective "material"? The new language does eliminate the old *de minimis* test[36] (anything more than a trifling injury is "injury"), but that test had never commanded a majority and had been abandoned in the early 1970s. The statute, however, defines "material injury" in a negative way that deprives it of vitality: the term "means harm which is not inconsequential, immaterial, or unimportant."[37] To underline the relative lack of significance to be attributed to "material," the House Committee stated its view that "the ITC's decisions from January 3, 1975 to July 2, 1979 have, on the whole, been consistent with the material injury test of this legislation and the agreement (the Amended 1979 Code)." It then translated this view into an admonition to the ITC by adding that "The Committee intends that standard to continue."[38]

As we have seen, the ITC's injury determinations during this period, while consistent with the Senate Committee report of 1974, were at odds with the 1967 Anti-dumping Code. It is a measure of the backward step taken in the new code and implementing legislation that the very conduct that was complained of by developed and developing countries alike during the 1970s, and that led to their efforts aimed at correcting these protectionist rulings, is now proclaimed to be the wave of the future.

Even that may not be the whole story. The Amended Code's treatment of "weighing" (or more precisely, not weighing) non-dumped import causative factors along with the causative qualities of such imports, itself a major retreat from the 1967 code, proved to be too small a retreat for Congress. The Amended Code's formulation on this score is that (Article 3 (4)):

> It must be demonstrated that the dumped imports are, through the effects of dumping, causing injury within the meaning of this Code. There may be other factors which at the same time are injuring the

industry, and the injuries caused by other factors must not be attributed to the dumped imports.[39]

When the U.S. administration attempted to secure approval of the MTN codes and suitable implementing legislation, it was forced to engage in an unprecedented degree of consultation and collaboration with Congress because of the greatly enhanced congressional role called for in the Trade Act of 1974. That act required agreements on non-tariff barriers to be approved by Congress; earlier trade agreements legislation had delegated authority to the President to conclude trade agreements within prescribed limitations. The technique adopted was to draft the new bill in consultation with the staff of the relevant congressional committees, and to spell out administrative intentions in lengthy "Statements of Administrative Action," which were sent to Congress by the administration (along with the draft of the proposed 1979 trade legislation) as an "accompanying part of the message from the President" transmitting the MTN agreements.[40] The House Committee report on the legislation consisted in large part of these "Statements," which themselves had been a collaborative effort by administration and congressional Committee staff personnel. There was some rewriting of the "Statements" in Congress in the process of their incorporation into the Committee report. Some of this rewriting was important. Causation of injury in anti-dumping and countervailing duties was one such area. As surely must be anticipated by now, the changes wrought by Congress do not come down on the side of liberal trade; they represent further backsliding, this time from the Amended Code of 1979 itself.

In explaining and interpreting the Amended Code's Article 3 (4) on "weighing," the administration's statement had said:

a. "By reason of" did not involve a weighing of dumped imports causation against other factors which may also be causing injury.
b. The ITC will consider information which may demonstrate that the harm is attributable to other factors, e.g., changes in patterns of consumption, trade restrictive practices, etc.
c. The domestic industry petitioner for an affirmative injury determination "must demonstrate, and the Commission must satisfy itself" that, in light of all the information presented, there is the requisite causal link "between dumping and material injury."
d. The petitioner will not be required to bear the burden of demonstrating a negative, namely, that the material injury is not by reason of such other factors as to which information has been introduced.[41]

This statement by the administration was an effort to walk a tightrope — to comply with the Amended Code's requirement that "it must be demonstrated that dumped imports are, through the effects of dumping, causing injury," while at the same time trying to reassure Congress that this would not be such a difficult task. The statement contained deliberate ambiguities. How does the ITC consider in any meaningful way the "other factors" that are causing harm without "weighing" them against dumped imports? Particularly, how can the ITC "satisfy itself" that dumped imports furnish the "requisite causal link" without somehow bootlegging into this perception these "other factors," within the same small fractions of time in which the human mind works? But on one score, that of the "burden of proof," both the Amended Code and the administration's statement were firm. Both stated that the party seeking to have anti-dumping duties imposed on the imported product "must demonstrate, *and* the Commission must satisfy itself" that material injury was "by reason of" the dumped imports. On this important overall burden-of-proof question, the petitioner, like a plaintiff in a lawsuit, had the labouring oar, and the Commission had the obligation to "satisfy itself" that the requisite causal link had been forged.

The House Ways and Means Committee, in the course of incorporating the administration's statement into its report on the legislation,[42] rewrote it. It repeated (*a*), (*b*), and (*d*) above, but deliberately omitted (*c*), the administration's statement regarding the petitioner's burden of proof — that there was the "requisite causal link" between dumped imports and injury, and that the Commission was obliged to satisfy itself concerning that link. This omission was doubtless because the House Committee considered that such a burden of proof would have "the undesirable result of making relief more difficult to obtain for those industries facing difficulties from a variety of sources, precisely those industries that are most vulnerable to subsidized or dumped imports."[43]

In short, if a domestic industry can show a downturn in profitability, with dumped imports contributing in small part to the downturn, material injury was to be found "by reason of" the dumped imports regardless of the large contribution of "other factors" to the domestic industry's loss in profitability. Thus, in March 1980, in *Spun Acrylic Yarn*, ITC commissioners found that the "negative effect" of dumped imports "has not been inconsequential," thus causing harm to an industry "that, as a general matter, has been experiencing some difficulty."[44] This finding was made even though during the first three quarters of 1979, more than six months before the ITC decision came down, Japanese imports constituted 1 per cent and Italian imports 2 per cent of U.S. consumption.[45] The U.S. industry, while going through a general shake-out for the past three or four years, had still managed to make good (though declining) profits despite this import penetration. But that degree of import penetration nonetheless indicated "a definite link" between dumped imports and "material" — that is to say, "not inconsequential" — injury, especially because the House Committee had stated in its report[46] that "overall injury caused by unfair competition" does not require "as strong a causation link" as would be required were dumping not involved.

By reducing causation and the quantum of injury to these lower levels, Congress has come a long way from the intentions expressed by the senatorial sponsors of the injury requirement in the 1921 act. Senator McCumber's aim to prevent purposeful predatory dumping and Senator Watson's desire to avoid the "destructive" effects on an industry of dumped imports appear to have little relevance to "injury" as it has evolved during the past sixty years.

The role played by the Amended Code of 1979, unlike that intended for the 1967 code, has been to aid and abet — to ratify — this grave weakening of the injury requirement. That part of the MTN represented by the Amended Anti-dumping Code of 1979 is thus a major backward step in the direction of the protectionism that it was the objective of the MTN to avoid.

Notes

[1] An overall average tariff reduction of 29 per cent from applied rates for the United States, European Communities, Japan, and Canada combined. U.S., Congress, House, Committee on Ways and Means, *Trade Agreements Act of 1979*, H.R. Rep. No. 96–317, 96th Cong., 1st sess., 1979, p. 12 [hereafter cited as House Report]. An individual country's reduction in rates (i.e., 2 points) is calculated as the drop from pre-MTN average percentage tariff levels on dutiable articles.

[2] *Ibid.*, p. 13.

[3] *Ibid.*

[4] *Ibid.*

[5] "The Antidumping Act — Tariff or Antitrust Law?" *Yale Law Journal* 74 (1965): 707–24, reprinted in Stanley D. Metzger, *Law of International Trade*, Vol. 1 (Washington, D.C.: Lerner Law Book, 1966), pp. 871–99.

[6] *Ibid.*

[7] *Ibid.*

[8] *Ibid.*, p. 882

[9] U.S. Tariff Commission, Publication 255 (July 1968).

[10] U.S. Tariff Commission, Publication 265 (September 1968).

[11] Metzger, *op. cit.*, p. 882.

[12] *Ibid.*, pp. 882–83.

[13] Canada first in 1904, South Africa in 1914. See J. Viner, "Dumping," *Encyclopaedia of the Social Sciences*, Vol. 5 (London: Macmillan, 1931), pp. 275–78. Indeed, Canada's law of 1904, amended in 1907 and 1921, had no injury test at all, calling for anti-dumping duties to offset dumping margins without specific inquiry into the effects upon domestic firms.

[14] *Congressional Record* (1921), pp. 1021, 1101.

[15] Tariff Commission, Publication 265, pp. 29–30.

[16] Stanley Metzger, "The Prospects for the Kennedy Round," in *The Expansion of World Trade* (London: British Institute of International and Comparative Law, 1965), pp. 24–25.

[17] For the background of the negotiations, see Rodney de C. Grey, *The Development of the Canadian Anti-Dumping System* (Montreal: Canadian Economic Policy Committee, 1973); and Ernest H. Preeg, *Traders and Diplomats* (Washington, D.C.: The Brookings Institution, 1970).

[18] See, generally, Hearing Before the Committee on Finance, U.S. Senate, 90th Cong. 2d sess., 27 June 1968 (a 388-page compilation of testimony for and against the code). See also Stanley Metzger, "Compliance with International Obligations: Some Recent United States and Canadian Injury Determinations under the International Anti-dumping Code," Occasional Paper 31 (Ottawa: Carleton University, Norman Paterson School of International Affairs), p. 7

[19] Administration of the Anti-dumping Act, P.L. 90 (1968), section 201 (a).

[20] *Ibid.*

[21] U.S., Congress, Senate, S. Rep. No. 93–1248, 93rd Cong., 2d sess., 1974 [hereafter cited as Senate Report].

[22] For example, U.S. International Trade Commission, Publication 739 (September 1975), pp. 10–14; Publication 732 (June 1975), p. 7; and Publication 727 (April 1975), p. 9.

[23] Federal Trade Commission, "Effects of Restrictions on United States Imports," Staff Report (Washington, D.C.: June 1980), p. 171.

[24] Senate Report, p. 180.

[25] *Ibid.*

[26] *Ibid.*

[27] See Metzger, "Compliance with International Obligations," pp. 13–26.

[28] Anti-dumping Act, 1968-69, c. 10, S. 1. See Grey, *op. cit.*, pp. 27–28; Grey's argument that the code's formulation "would have caused uncertainty" is unconvincing. It would have caused fewer affirmative injury determinations, not uncertainty.

[29] See Metzger, "Compliance with International Obligations," pp. 28–40.

[30] See Philip Slayton, "The Canadian Legal Response to Steel Dumping," *Canada–United States Law Journal* 2 (1979): 81–94; Stanley D. Metzger, "Comments on Professor Slayton's Paper on Steel Dumping," *Canada–United States Law Journal* 2 (1979): 95–100.

[31] Analysis of the Results of the Multilateral Trade Negotiations, Part II, UNDP/UNCTAD Technical Assistance Project of the MTN, Geneva, September 1979, UNCTAD/MTN/CB. 18/Rev. 1/Part II GE. 79-54081, p. 20.

[32] *Ibid.*, p. 21

[33] Section 303 of the Tariff Act of 1930 (19 U.S.C. 1303 (1952)).

[34] Technically called Agreement on Interpretation and Application of Article VI of the General Agreement on Tariffs and Trade. Reprinted in *Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations*, H.R. Doc. No. 96–153, 96th Cong., 1st sess., 1979, pp. 311 and following.

[35] See Bill Alberger, "The Concept of Injury in United States Trade Law — The Role of the U. S. International Trade Commission," paper read at University of Liège Seminar, 18–20 October 1979, p. 17.

[36] House Report, p. 46.

[37] Trade Agreements Act of 1979, P.L. 96–39, Sec. 101, 19 U.S.C. 1977 (7)

[38] House Report.

[39] U.S., Congress, House, *Agreements Reached in the Tokyo Round of Multilateral Trade Negotiations*, Part I, H.R. Doc. No. 96-153, 96th Cong., 1st sess., 1979, p. 315. Footnotes omitted.

[40] U.S., Congress, House, *Agreements Reached in the Tokyo Round of Multilateral Trade Negotiations*, Part II, H.R. Doc. 96–153, 9th Cong., 1st sess., 1979. The entire document comprised 547 pages, pages 1–387 containing the proposed legislation, and pages 388–547 the "Statements of Administrative Action."

[41] *Ibid.*, pp. 434–35.

[42] House Report, pp. 46–47.

[43] *Ibid.*, p. 47.

[44] ITC Publication No. 1046, pp. 10–11.

[45] *Ibid.*, p. 22.

[46] House Report, p. 47.

The Impact of the GATT Agreement on Government Procurement in Canada

8

by
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1. Introduction

The adoption of the Agreement on Government Procurement[1] constitutes an interesting and significant new departure for the Contracting Parties to the General Agreement on Tariffs and Trade (GATT). Long considered to be an area of trade from which foreign suppliers were virtually automatically excluded in all major trading states, however liberal their general philosophy of international trade, government procurement was an obvious area for the participants in the Tokyo Round to prove their willingness to dismantle non-tariff barriers. Given the very great difficulties inherent in their enterprise, the Contracting Parties have achieved a considerable measure of success in bringing the negotiations to a conclusion. The agreement leaves much to be desired, but it contains many genuine mutual concessions: apart from the tariff concessions, the agreement constitutes the only other element of the Tokyo Round that can be calculated in terms of direct economic advantage. However, the real test is yet to come. Until the agreement is fully implemented,[2] it will not be possible to assess the full measure of success or failure of the Contracting Parties.

Purchases of goods and services by governments constitute an important and seemingly ever-increasing percentage of the GNP's of many states. In Canada, purchases of goods and services by federal government departments, agencies, and Crown corporations amounted to over $9 billion in 1977–78, while purchases by the Department of Supply and Services, designated as the common service agency for the procurement of goods and services, made purchases in the amount of $2.4 billion in the same year. Procurement by all levels of government in that year in Canada is estimated to have amounted to some $30 billion. Of the goods and services purchased abroad in 1977–78 by the the Department of Supply and Services, some $300 million were purchased from foreign-based suppliers.[3] More generally, a substantial volume of the international trade of all states[4] is attributable to government purchases.

Whether overtly,[5] or by less obvious but equally effective means, as in Canada, access to this important area of the economy is very largely reserved to domestic suppliers. Until the last decade, the issue was hardly open to discussion and debate, and governments held it as an article of faith that they should, whenever possible, return tax revenues to their own economies by reserving the bulk of their purchasing to their domestic suppliers; for this reason governments have been slow to criticize others for adopting a similar course. Despite the fact that this practice must in at least some cases increase the tax burden through increased costs, there has been in the past and even today there is little or no public criticism of this government policy. Indeed, it is an open question as to whether the Canadian government and other governments will be able to implement this agreement without incurring considerable criticism.

A number of reasons can be cited for the present situation, some economic and some political. The most significant factors favouring domestic suppliers over foreigners are proximity and familiarity. Even in a vast country like Canada, domestic suppliers are likely to know the needs of their government departments and to be more able to supply these needs with acceptable products. In the same way, government buyers are more likely to turn to the domestic enterprises they know best; assurances of delivery, control of quality, lack of transportation difficulties, and certainty as to legal recourse in the event of difficulties are contributing factors of some importance. Governments often use procurement policies as a conscious means of promoting economic development, to attract new industry, to develop and maintain industrial capacity especially in relation to defence, and to assist flagging industries or economically underdeveloped regions; in some sectors a virtual symbiosis exists between regulated industries, such as railways or communications, particularly the European postal and telecommunications services, and their suppliers, which is reinforced by government procurement policies.

Beyond such openly articulated policies lie a number of political assumptions shared by governments and their electorates alike that are equally important. Most governments perceive themselves as being highly vulnerable to the charges of "neglecting national interests," "exporting jobs," and failing to "protect" domestic industry when they are in a position to do so. In short, we are dealing with a sacred cow.[6]

From the above it can be seen that the obstacles to liberalizing governmental practices in the field of procurement are very great. At the present time in Canada, the Department of Supply and Services makes 80 to 85 per cent of its annual purchases of goods and services from domestic suppliers.[7] The situation is similar, if not more closed, in other countries.[8] Nevertheless, the Contracting Parties to the

GATT have made a concerted attempt to open up national markets in this area. This essay is devoted to an analysis of the agreement and to an assessment of its impact, particularly upon Canadian federal government procedures and policies.

2. Analysis of the Agreement

A. History

The ill-fated Havana Charter contained no provisions concerning government procurement.[9] The GATT itself does not apply to the subject.[10] The Canada–United States Defence Production Sharing Agreement[11] makes provision for mutual access to the defence procurement markets of these closely allied countries. Beyond this, government procurement does not appear to have been the subject of international negotiation except within the European Free Trade Association, until taken up by the Organisation for Economic Co-operation and Development (OECD) in the mid 1960s.[12] The reason for consideration of this issue at the OECD was the growing concern for non-tariff barriers as tariff barriers themselves were lowered, particularly after the Kennedy Round.

In Canada, the issue was the subject of industry and government consultations in 1970, as a result of which the government of Canada determined to give it higher priority in international negotiations. In the European Community (EC), largely for internal reasons, barriers to government procurement markets became a matter of concern at about the same time and it was determined at the Paris Summit of October 1972 to take action to open up public and semi-public procurement throughout the Community. Two distinguished public servants, Guy Charpentier and Sir Richard Clarke, were commissioned to conduct a study of existing member-state practices and procedures to determine why such barriers existed to intra-community trade and to make recommendations for the lowering of such barriers. The resulting Charpentier-Clarke report,[13] although chiefly directed towards the problem of intra-community barriers, provided the guiding philosophy for both the development of new EC policies[14] and, equally important, for the development of the EC negotiating position *vis-à-vis* its trading partners.

Government procurement was studied by an OECD committee from 1965 to 1976.[15] During this period many of the basic problems were debated and draft guide-lines prepared.[16] The basic issues that emerged were those of (*a*) "transparency," that is, the degree of publicity to be given to interested parties as to the process of awarding government contracts and the nature of the decision in respect of individual contracts; (*b*) coverage, both in terms of the goods and services in question and the institutions whose contracts should be subject to the new rules; and (*c*) dispute settlement in the event of unsatisfactory procedures or decisions by institutions covered by the new rules.

Basic differences of philosophy existed between the EC and the United States and Canada on the issue of transparency, with the EC favouring transparency *ex ante* the awarding of contracts, while the United States and Canada stressed transparency *ex post facto*. At the inception of negotiations, very wide disagreements existed between states as to the products that should be covered and the institutions whose practices should be opened up. Thus, following the Charpentier-Clarke report, the EC argued that procurement by public utilities was a separate and severable issue. Other states argued that defence procurement and agricultural commodity buying should be left out. The process of negotiation that developed in this area closely resembled that prevailing in respect of tariffs. Special interests, whether of protection or access, were assessed in each state, the costs and benefits of a global offer were weighed, and then, once made, the offers were assessed in the light of the offers of other states. Since the issue was a new one, the negotiations began slowly in respect of coverage, and it is difficult to see any guiding philosophy inherent in the process or in the final result, unless it is a genuine desire to make a start on lowering trade barriers in this field. Dispute settlement was a priority for some states such as Canada, and much less so for others such as Japan.

Negotiations within the OECD did much to help define issues and to force states to develop coherent positions. The draft guide-lines reflected this progress but also reflected continued divergence of opinion on a number of fundamental issues. By 1976, the OECD negotiations had reached a virtual stalemate. Due to this situation, Canada first, then the United States and a number of developing countries led by India urged successfully that the negotiations be transferred to the GATT forum. The chief participants in the subsequent Tokyo Round negotiations were the United States, the EC, Japan, the Nordic States, Switzerland, Canada, and several of the major developing states. Of the principal protagonists, the United States, the EC, and Japan, the latter is reported to have been the most reluctant to make changes in the *status quo*. Negotiations were based on OECD drafts and new Contracting Party proposals.[17] The key elements were "offers" as to coverage,[18] but difficult negotiations also centred on transparency, economic offsets, and technology licensing.

As in other Tokyo Round negotiations, small states played a considerable role in formulating issues and working towards compromises, but in the end the basic decisions were taken by the United States, the EC, and Japan.

The resulting agreement was received with considerable satisfaction by representatives of the developed Contracting Parties. Ambassador Warren, Canadian co-ordinator for the MTN, has stated that "the agreement will provide significant new export opportunities for Canadian suppliers over a broad range of products normally purchased by governments."[19]

B. Transparency

The basic standards in respect of the rules and procedures of government procurement covered by the agreement are those of national treatment and its concomitant, the principle of non-discrimination. By virtue of Article II.1, parties are required to provide national treatment to both the goods and suppliers covered by the agreement as well as to extend treatment equal to that accorded to any other party.[20] Thus those products and suppliers enjoying the benefits of the agreement are offered a very real advantage over the present situation thereby greatly enhancing their possibility of access to the government procurement markets of other parties.[21] As further protection of these rights, it is set out in Article II.3 that parties shall apply the same rules of origin to government procurement as prevail in respect of other imported products.

Article IV sets out a few general obligations on parties in respect of technical specifications for products in the government procurement market. This article lays down the basic rule that technical specifications[22] shall not be adopted or applied "with a view to creating obstacles to international trade" nor shall they "have the effect of creating unnecessary obstacles."[23] Such technical specifications set by government procurement agencies are to be in terms of "performance" rather than "design" and are to be based on "recognized" national and international standards.[24] Procurement entities are not to specify particular trade marks, patents, and so on, except in exceptional circumstances, and where they do so they must specify that they will accept equivalent products.[25] It should be noted that this article in effect incorporates the rules of the Agreement on Technical Barriers to Trade[26] in respect of government procurement. It is reported that this article was relatively non-controversial, since it incorporated principles already agreed to in other codes; however, it may well be that difficulties will arise in its implementation, since, as recognized in Article 2.1 of the latter agreement, technical specifications can be used as a way of narrowing down the field of potential suppliers and thereby serve as obstacles to international trade.

Article V of the agreement governs all tendering qualification and contracting procedures of government procurement entities. In respect of the qualification of suppliers, the basic rule is that of non-discrimination between foreign suppliers and, even more significant, non-discrimination between foreign and domestic suppliers.[27] Thus the principle that is now the exception will become the rule when the agreement enters into force; the reservation of government procurement contracts for those products and suppliers covered will no longer be the preserve of domestic suppliers of the contracting state. Pursuant to this principle, Article V.2 requires that adequate notice will be given of all conditions precedent for participation in the tendering process, that such conditions shall be "no less favourable"[28] for foreign than for domestic suppliers and shall not be used to discriminate against foreign suppliers. Procurement entities are required to include "qualified" foreign suppliers on their source lists "within a reasonably short time"[29] of a request for inclusion.

Procurement entities are required to give notice of "each proposed purchase"[30] in a publication designated in Annex II of the agreement.[31] Such notices must include information on the following issues, *inter alia*, nature and quantity of the products, whether the tendering procedure is open or selective, the delivery date, the final date for inclusion in a list of suppliers or for submission of the tender itself. A further summary of such information must be published in one of the official languages of the GATT.[32] The agreement accepts the practice of many states of maintaining source lists of potential suppliers but requires that procurement entities should "invite tenders from the maximum number of domestic and foreign suppliers, consistent with efficient operation of the procurement system."[33] Entities maintaining selective tendering systems, particularly lists of qualified suppliers, are required to publish annually in a designated publication (*a*) an enumeration of the lists maintained in relation to categories of products, (*b*) conditions for registration of suppliers on these lists, and (*c*) the period of validity of the lists.[34] Entities maintaining such lists may choose their suppliers from those on the list, provided that the selection process allows "equitable opportunities"[35] for all suppliers on the list, whether domestic or foreign.

The prescribed time-limit for tendering must be gauged to allow foreign as well as domestic suppliers to tender.[36] In open procedures and selective procedures not involving a permanent list of suppliers, the limit is to be no less than thirty days from the date of notice of the proposed purchase; in respect of selective procedures involving permanent lists of suppliers, thirty days must elapse from the date of issuance of invitations to tender, unless a shorter period is essential for reasons of urgency.[37] Tender documentation in selective procedures must include all relevant information including the criteria for awarding the contract.[38] In open procedures, procurement entities must forward tender documentation to any supplier, whether foreign or domestic, requesting it; in selective procedures, procurement entities must forward tender documentation to any supplier wishing to participate.[39]

From the above it can be seen that a considerable effort has been made to open up existing tendering procedures, with a view to ensuring that foreign suppliers desiring it have access to information as to the proposed purchases, suppliers' lists, and the means of tendering for available contracts. In this respect satisfaction has been given to the EC and Japan who laid stress on the need for transparency *ex ante*. However, the agreement does not stop there: Article V goes on to deal with the concern voiced, among others, by the United States and Canada that transparency also be ensured after the fact.

Tenders are to be submitted in writing and not verbally in order to ensure the existence of an adequate record.[40] More important still is the principle that "the receipt and opening of tenders shall also be consistent with the national treatment and non-discrimination provisions of [the] Agreement."[41] In the case of open procedures, tenders are to be opened in the presence of tenderers or their representatives, and a report on the opening of the tender is to be drawn up and the text made available for possible future reference.[42] Article VI requires entities to inform unsuccessful applicants for inclusion on suppliers' lists the reasons of their rejection: entities are also required to give unsuccessful tenderers, within seven days, notice of the award of a contract and also, if requested, to give "pertinent information"[43] concerning the reasons why their tender was not selected. There is thus a considerable measure of *ex post facto* control in the agreement.

Article V.14(f) is the basic rule in respect of the awarding of open or selective contracts:

> unless in the public interest an entity decides not to issue the contract, the entity shall make the award to the tenderer who has been determined to be fully capable of undertaking the contract and whose tender, whether for domestic or foreign products, is either the lowest tender or the tender which in terms of the specific evaluation criteria set forth in the notices or tender documentation is determined to be the most advantageous.

This rule stresses price but clearly allows procurement entities to exercise a considerable amount of discretion in awarding a contract. In the event that all tenders are in the same competitive range, procurement entities must give "equal consideration and treatment" to all such bids.[44] A special rule is set out with respect to "offset procurement" and tied licensing of technology, whereby procurement entities are enjoined to "normally refrain" from imposing such conditions.[45] Clearly the language leaves considerable discretion to parties, and it can be doubted that governments such as the Canadian government will change existing policies requiring industrial offsets in major contracts involving foreign suppliers.[46] However, the language would appear to prohibit using offsets as a technique of discrimination.

Finally, while single tendering, that is, calling upon a single supplier to tender, is allowed by the agreement, entities are enjoined not to make it a means of discrimination. The same condition of preparing a report obtains in respect of single tenders as with open and selective procedures.[47]

C. Coverage

The agreement applies to products and to "services incidental to the supply of products." Service contracts generally are not covered. This approach was shared by most states and therefore was not an issue of controversy, since it was considered that service contracts raised a range of different considerations due to the nature of these contracts. Similarly the agreement does not apply to research and development contracts. Nor does the agreement apply to military procurement of armaments and materiel related in any way to military security. Finally, the agreement does not apply to contracts of less than SDR 150 000 in value.[48] This figure represents a compromise between the United States, which sought a $10 000 limit to facilitate access to the Japanese market, and Japan and the EC, which favoured a higher figure. Canada took no firm position on the threshold.

The nature of the coverage of the agreement can be determined essentially by reference to the governmental institutions ("entities") whose purchases are subject to it. There are some direct references in Annex I to products or commodities, and the choice of entities was largely determined by the type and value of the products and commodities that they purchased. These factors were therefore uppermost in the minds of delegations throughout the bargaining process, but the agreement itself is largely drafted in terms of specific entities that are set out in Annex I.

It would appear that the process of bargaining coverage generally resembled tariff bargaining although they were conducted in a relatively informal and unstructured manner. Each delegation prepared a list of those entities of their principal trading partners whose purchases would be of interest to their industries. Conversely each delegation drew up a list of the entities within their own government whose purchases they were prepared to open up to foreign tendering. They also drew up a list of those products that could not be open to foreign tendering. The lists when exchanged constitued, as with tariff lists, requests and offers. In the subsequent bargaining, each delegation from developed countries sought to balance out their offers with the value of the offers of their counterparts. A rough balance was sought between the relative size of national economies of developed countries. Also between developed countries, a fair degree of reciprocity of coverage was sought as between each trading partner in terms of the calculation of the potential value of purchasing between them.

Whether such reciprocity has in fact been reached will only be determined after implementation of the agreement. The Canadian list,[49] whose potential 1977–78 value was estimated by the Department of Supply and Services to be worth about $1 billion,[50] is composed essentially of departments of the government of Canada and some major agencies. The list is close to but not identical to those departments and agencies covered by the *Government Contracts Regulations*.[51] The Department of National Defence is included, but only for purchases involving items of a non-military nature such as tractors, service and trade equipment, construction equipment, and office equipment.[52] The Post Office is included, but only so long as it remains a department of government. The Departments of Communications and Transport are not included in the Canadian list, nor is the Fisheries and Marine Service of the Department of Fisheries and the Environment.

Notably absent from the Canadian list are the major federal Crown corporations. The writer was informed that Canada was prepared to make offers involving Crown corporations, despite misgivings as to whether the rules of transparency could be readily applied to commercial operations such as those of Air Canada, but in the light of the offers of other delegations it was not necessary to "dip that far into the barrel." Similarly the Canadian list does not include any provincial government departments or Crown corporations, since Canada made no offers affecting them; their purchasing practices are therefore not touched by the agreement. The Charpentier-Clarke report had recommended that public utility purchasing be treated separately from purchasing by government departments. As a result of the refusal of the EC to include utilities, the U.S. offer did not include the U.S. Corps of Engineers or the Tennessee Valley Authority, and the like, and Canada did not have to offer access to utilities under federal jurisdiction.

Of particular export interest to Canada, among items that might have been covered, were telecommunications, heavy electrical power generation and transmission, and transportation equipment. Due to the EC policy, these items were not included in the agreement.[53]

However, despite these limitations, it has been stated by Ambassador Warren that the agreement is favourable to Canadian interests and indeed that "the volume of procurement opened in foreign markets will be much larger than the amount of Canadian government purchasing which will be opened to foreign suppliers."[54]

The broad picture of the governmental purchasing entities covered by the agreement in other states is similar to the obligations accepted by Canada. Thus, in the United States, the principal departments of the federal government are covered with the exception of the Department of Transport; unlike Canada, a large number of regulatory agencies are included. The American list pertaining to the Department of Defense lists both items excluded and those "generally" included within its scope; purchasing programmes designed to aid small business are excluded. The value of potential purchasing opened up to all foreign suppliers by the United States is estimated at $12 billion.[55] There is no reliable estimate of the percentage of this that is likely to accrue to Canadian suppliers. A similar pattern prevails in the lists of entities of Canada's other principal trading partners.

The lists of items of less developed countries (LDC's) are uniformly shorter,[56] reflecting the very different philosophy of non-reciprocity prevailing in negotiations between LDC's and developed countries. As yet only a limited number of LDC's have indicated willingness to sign the agreement. No state-trading states have as yet indicated an interest in signing the agreement.

D. Dispute Settlement

The extensive dispute avoidance and dispute settlement procedures of the agreement in many ways mirror the existing practices of the GATT and the other Tokyo Round agreements. Article VI sets out detailed requirements concerning the furnishing of information. Parties must explain their procedures to potential suppliers and tenderers and must be prepared to explain to disappointed suppliers or tenderers why they have not been successful. There is also a requirement that entities maintain an adequate complaint procedure. Finally, parties are required to publish annual statistics on government contracts, including the nationality of successful tenderers[57] or country of origin of products purchased.

Dispute settlement is in the hands of a "Committee on Government Procurement" (hereinafter the Committee) composed of representatives of each of the parties. Entities must respond to complaints made by suppliers. If this fails, the government of a supplier may make representations to the entity. When these two steps fail, the agreement provides for interstate procedures. Parties are required to hear and respond to representations from other parties especially when one alleges "nullification or impairment" of benefits accruing under the agreement;[58] if no solution can be reached, the matter can be referred to the Committee, which must seek to promote a solution or, failing this, constitute a panel to (*a*) examine the situation, (*b*) consult with the parties, or (*c*) make a statement of the facts and "findings" that will help the Committee to reach a solution. Panels are chosen by the Committee chairman from a list of government experts who participate in their individual capacities. Panels are empowered to adopt whatever procedures they consider useful with a view to establishing the facts and reaching a solution. In the event that a solution is not evident or interpretation of the agreement by the Committee is required, the panel must consult with the parties in preparing its report.[59] This procedure should normally be completed within four months.

Within thirty days of receipt of the report of a panel, the Committee should take "appropriate action"[60] including a statement of facts, "recommendations," and "any other ruling which it deems appropriate."[61] Should a party fail to heed this report and fail to provide adequate reasons for doing so, the Committee is empowered to take "further action" including partial or total suspension of the agreement in respect of the party failing to respect its obligations.[62]

E. Less Developed Countries

As noted above, the agreement was not negotiated in a spirit requiring strict reciprocity of obligations between developed and developing parties. This is particularly reflected in the restricted coverage agreed for those few LDC's that have already signed the agreement. The LDC parties enjoy all the benefits of the agreement in terms of access to entities; they are equally subject to the various provisions of the agreement in respect of national treatment and dispute settlement. However, Article III indicates that special treatment is to be accorded to LDC's in the implementation of the agreement. This special treatment takes a variety of forms;[63] its impact is that the agreement will not be applied to LDC's with the same rigour as to developed countries and that coverage will be extended gradually to their entities and not on a basis of reciprocity. The language of Article III is nebulous but seems to indicate a desire to apply the agreement to LDC's in a manner that recognizes their economic weakness and seeks to alleviate the consequences of this weakness.

F. Final Clauses

The agreement does not enter into force until 1 January 1981,[64] by which time all parties are required to bring their laws and procedures into conformity with it.[65] Present signatories, other GATT Contracting Parties, and other governments may acceed to the agreement on terms agreed with the parties.[66] Subject to the rights of LDC's, parties may only modify their lists in exceptional circumstances, and that right is subject to review by the Committee, which is charged with "maintaining a comparable level of mutually agreed coverage."[67] The Committee is required to review the operation of the agreement annually, and within three years the parties are required to undertake negotiations with a view to extending coverage.[68] No reservations may be entered to the agreement.[69] Parties may withdraw on notice of sixty days.[70]

3. Impact of the Agreement in Canada

A. Existing Laws, Regulations, and Policies

Government procurement practices in Canada are today governed by a number of laws, regulations, and policies. None of these are as openly protectionist as the Buy American Act[71] or the French *Code des marchés publics*;[72] however, the total impact of these measures is quite clearly restrictive of foreign access.

No general statute sets out a comprehensive government procurement policy at the federal level. The Financial Administration Act[73] and the Appropriation Acts govern the expenditure of federal monies. The Department of Supply and Services Act[74] gives the minister of that department authority relating to the purchase of goods and services for all the government of Canada, subject to certain legislative exceptions, and designates the department as "a common service agency."[75] The Public Works Act[76] gives similar authority to that department in respect of construction contracts. However, none of these acts contain specific provisions as to the source of government purchases of goods and services. The Defence Production Act[77] gives the minister of supply and services authority to acquire "defence supplies and construct defence projects."[78] In the light of section 10 of the same act,[79] the minister has used his powers in the area of procurement to favour Canadian interests except where access by U.S. companies is authorized by the Defence Production and Sharing Agreement[80] existing between Canada and the United States. With the exception of the non-military items on the Canadian list, procurement by the Department of Supply and Services on behalf of the Department of National Defence will continue to be subject to existing laws and policies[81] and will not be affected by the agreement.

Government procurement at the federal level is largely regulated by the following documents: the *Government Contracts Regulations*;[82] two Treasury Board Administrative Policy Manuals — *Contracting*[83] and *Procurement Review*;[84] and the Department of Supply and Services' *Supply Policy Manual*.[85]

The system of government procurement established by the documents listed above can be summarized as follows. The Treasury Board retains overall supervision of the expenditure of government monies, setting general policies and in more important cases intervening directly in procurement decisions. The *Government Contracts Regulations* made under the Financial Administration Act grant authority for departments, and certain Crown corporations, to purchase goods and services or to enter into construction contracts. Under the *Government Contracts Regulations*, many departments have been delegated authority to make small purchases of goods[86] and services,[87] or to enter into construction contracts[88] without the consent of

Treasury Board. However, as the Department of Supply and Services (D.S.S.) is designated as the "common service agency" for government procurement of goods and services, it plays a central role both in making a great number of purchases and setting general purchasing policy. Thus, without Treasury Board approval, D.S.S. may make purchases of services and goods worth under $1 million if two or more valid tenders are received.[89] Above this limit, D.S.S. remains the contracting authority subject to Treasury Board policies and directives in specific cases. In the field of construction contracts, the Department of Public Works is designated as the common service agency and operates on a similar basis. In addition, other departments such as National Defence, Transport, Indian and Northern Affairs, or Justice are given authority to enter into certain contracts.

The general rule for government procurement contracts is that no contract may be entered into before the contracting authority has invited tenders.[90] Tenders for construction contracts are invited via the newspapers. Tenders for goods and services contracts are invited either by advertisements in newspapers or from a list compiled by the contracting authority and deemed "representative of the suppliers of the required goods and services."[91] The rule as to tenders is waived in cases of (*a*) emergency, (*b*) less than $15 000 value, (*c*) where the nature of the work precludes public tendering in the public interest, and (*d*) where only one supplier is judged capable of performing the contract.[92]

The *Government Contracts Regulations* are, on their face, entirely neutral as to domestic or foreign procurement in the sense that they contain no explicit requirement that purchases be made from Canadian-based rather than foreign-based suppliers. Treasury Board Policy c. 310 is almost equally laconic on the issue although the criteria for choice of tenders have a bearing on the issue. It is stated:

> The clear identification of the significant requirements of the tender documents generally should have the result that the tenderer offering the best value also submits the lowest tender. . . .
>
> In any case where the lowest tender is not accepted, full justification for such action shall be set out on the contract file.[93]

Considerable discretion therefore exists at the level of determination of "best value." This is made clearer elsewhere in the same directive where it is stated:

> Government contracting shall be conducted in a manner which will:
>
> — achieve the optimal combination of quality, time and the total life-cycle costs of the acquisition
> — reflect fairness in the spending of public funds
> — when appropriate, relate to national policies and objectives.[94]

The basic rule as to the choice of method of selection of suppliers is that the method of acquisition should "provide an equal opportunity to all qualified firms to have access to government business." Firms are considered qualified that have the necessary technical, managerial, and financial competence, and "where appropriate" meet "criteria established by national policies and objectives."[95] There is thus no explicit requirement to purchase from Canadian-based firms, although the text appears more geared to domestic purchasing rather than purchasing from foreign-based suppliers.[96]

The very recently adopted Treasury Board Policy c. 305 *Procurement Review*[97] proposes a "procurement review mechanism" aimed at obtaining significant socio-economic benefits in Canada from government contracting. All contracts of over $2 million for goods and $10 million for services are to be submitted to the "PRM" process.[98] This policy is based on a policy paper of the Liberal government in 1979,[99] a policy unchanged by the Conservative government of 1979–1980 and seeoingly continued after February 1980 by the new Liberal government. The policy enunciated in this document is to promote economic development, particularly in high unemployment regions, and to promote technological change and research in Canada through government purchasing. At first blush the thrust of the government policy and the PRM would appear to be restrictive of foreign procurement and hence run counter to the purposes of the Tokyo Round. This conclusion may be premature and unfounded. A close reading of Treasury Board Policy c. 305 reveals no explicit requirement to exclude foreign-based firms from government contracts; what is sought are significant economic benefits in Canada from such contracts. If this can be achieved without giving preference to Canadian-based firms, then there may be no potential conflict between the new policy and the agreement. In any case it must be noted that Treasury Board Policy c. 305 states that any PRM decisions must be "consistent with Canada's international obligations such as the GATT Agreement on Government Procurement. . . ."[100] It is thus clear that the agreement prevails in the event of a potential conflict between Treasury Board Policy c. 305 and the agreement. The fact that the government of Canada should have chosen this moment to adopt such a policy must raise some doubts as to the extent of Canada's commitment to opening up government contracts to foreign suppliers over and beyond that covered by the agreement.

A further significant policy document governing foreign access to government procurement is the Department of Supply and Services' *Supply Policy Manual*. The thrust of this document is to give priority to Canadian-based suppliers.[101] For the purposes of access to tendering or inclusion on D.S.S. source lists of contractors, four categories of potential suppliers are established:

1. The principal category consists of
    a. Canadian-based manufacturers
    b. Canadian-based rationalized multinationals
    c. Canadian-based companies which are agents of (*a*)
    d. Canadian-based companies providing desired services
2. Canadian-based companies acting as agents of foreign companies and offering after-sales services
3. Canadian-based companies acting as agents of foreign companies and offering no after-sales services
4. Foreign-based manufacturers' sales agents.

If three or more tenders can be obtained from category (1) companies, then D.S.S. will look no further down this list. The clear impact of this policy is to confine eligibility to tender for government contracts to Canadian-based manufacturers of products in the great majority of cases. The same document also contains policies designed to promote regional economic expansion and the development of Canadian industry. It should be stressed that "Canadian based" is interpreted by D.S.S. as physically established in Canada. No test as to "national" origin, state of incorporation, or beneficial ownership is applied by D.S.S.

The net result of existing policies is that over the last decade no more than 15 to 20 per cent of all D.S.S. government procurement, on average, has been available to foreign suppliers.[102] The bulk of this 20 per cent has been in high technology and defence fields where no Canadian capacity has existed. In recent years the federal government policy has been much more aggressive in requiring technology and manufacturing offsets from foreign suppliers in these areas.

B. Implementation of the Agreement in Canada

During the course of 1980, a serious and concerted effort was being made by officials in the Departments of Supply and Services, Industry, Trade and Commerce, and the Treasury Board to prepare to implement the agreement on 1 January 1981. A decision has already been taken that no legislative changes are presently required in this area. Secondly, it does not appear to responsible officials that any changes are required to the *Government Contracts Regulations*. Thirdly, it is not yet certain that any change will be forthcoming to existing Treasury Board policies or that any new policy will be issued. Considerable changes will be required at the administrative level, first of all in D.S.S. and, secondly, in the other departments and agencies on the Canadian list. Within D.S.S., additional directives will be required to supplement the *Supply Policy Manual*.

The first question to be asked in respect of implementation is the extent of coverage in Canada at the federal level. Defence procurement, the largest single item, is virtually excluded. Service contracts, except for services incidental to the purchase of goods, are also excluded. It should be noted that this category includes construction contracts, another high-value area of government spending. Many purchases by the Departments of Transport and Fisheries are also excluded. Purchases by most federal Crown corporations and many other federal agencies are not covered. What then is covered? Largely the purchase of goods by D.S.S. through other departments and agencies on the Canadian list, excluding any contracts for research and development. Of these goods, the very great majority will be purchased through D.S.S. as the central agency. In 1978–79, the value of these purchases was worth about $1 billion,[103] or roughly 10 per cent of the total 1978–79 procurement expenditures of the government of Canada and its agencies,[104] or roughly 40 per cent of D.S.S. purchasing in that fiscal year. Thus the "net gain" by other parties to the agreement will be the difference between the value of the goods covered by the agreement and presently purchased by D.S.S. from Canadian-based suppliers, and those that in the future can be, and actually are, supplied by foreign suppliers. Taking the figures of 1978–79, this would amount to a maximum of $1 billion.[105]

What measures are being taken within the government of Canada to ensure that potential foreign-based suppliers enjoy the benefits of the agreement? The major change will be with respect to the D.S.S. *Supply Policy Manual* in so far as it presently excludes foreign-based suppliers from access to government contracts. A Committee of Directors-General has been established within D.S.S., including responsible officials from other departments and agencies, to oversee implemention of the agreement. Since the *Supply Policy Manual* covers a very wide range of situations and since all the implications of the agreement may not be foreseen in a precise way, it is not proposed to reformulate the *Manual* at this time; rather a new interim manual is being prepared to guide purchasing officers in all cases where the agreement may be applicable. At the present time, efforts are being made by D.S.S. officials to educate their own purchasing officers and those of relevant departments and agencies as to the impact of the agreement upon them.

The most immediate impact of the agreement will be to alter the present rules governing priority of access of suppliers or priority of choice of potential suppliers. The basic restriction of contracting to category (1) companies, that is, Canadian-based companies,[106] can no longer be applied to entities covered by the agreement. Hence foreign-based suppliers will be allowed to tender and will be allowed to request inclusion on source lists of suppliers and, once included, will have to be treated on a non-discriminatory basis. Invitations to tender in single-source situations will have to be conducted on a non-discriminatory basis.

Before 1 January 1981, measures will have to be taken to ensure appropriate publicity for contracts and, perhaps even more significant given the manner of D.S.S. procurement, to ensure publicity abroad of source lists maintained by D.S.S. Among the problems posed by the agreement is that of certifying that a foreign company is qualified for inclusion on a source list. The department considers that it and the client department alone are empowered to make such an accreditation and may not be prepared to see Canadian embassies or Industry, Trade and Commerce officers abroad make such judgements. However, given the obvious difficulties of time, distance, language, and so on, no easy solution is available. It is probable that foreign companies desiring to do business with D.S.S. will have to send representatives to Canada and will have to do most of the work involved in learning about how to contract themselves. One possible solution would be for D.S.S to use the accreditation procedures of other governments. This is a practical possibility with respect to at least the United States and the United Kingdom.

The extent to which equal and non-discriminatory treatment can be guaranteed to foreign companies in respect of tenders on a specific contract or in the choice of suppliers from a source list of the pre-selection of tenderers can only be a matter of conjecture. All will depend upon the spirit of fairness and openness that animates the future decisions of officials and of the government of Canada. The department will retain full discretion to decide on matters of price, quality, after-sales services, speed and place of delivery, appropriate performance bonds, and general suitability of the products offered. At least during the initial period, the factors of D.S.S. familiarity with Canadian companies and products will be hard for foreign suppliers, especially those outside the United States, to overcome.

To meet the terms of the agreement, D.S.S. must gather and report statistics on foreign tendering and the amount of contracts awarded to foreign firms. Equally important, D.S.S. will have to develop methods for dealing with foreign complaints that may ensue from unsuccessful tenderers or their governments as a result of loss of contracts or exclusion from source lists. One method will be the maintenance of the appropriate records of tenders made by foreign suppliers. As yet no procedure has been announced.

C. Assessment of the Significance of the Agreement to Canada

Given what would appear to be relatively modest economic concessions by Canada, the practical difficulties that lie in the way of foreign suppliers and the somewhat ambivalent general position of the government of Canada towards procurement policy, does the agreement offer genuine advantages to other parties? Similarly, should Canadian manufacturers look forward to greatly expanded markets in the United States, Europe, and Japan as a result of the agreement? In the short term it is unlikely that a great volume of new trade will be created between the parties; furthermore there is likely to be a period of reassessment and reaction within government procurement circles as the true extent of the various "offers" becomes clear and as the obstacles in the way of implementation of commitments make themselves felt. The very desire of parties to make this agreement succeed has yet to be proven by actions rather than words. However, it must be noted that in the face of a decision by the EC, the United States, and Japan to adopt such an agreement, Canada had little choice but to go along with this decision and to attempt to derive the maximum benefit from it, while at the same time conceding a comparable level of advantages to foreign suppliers. It is impossible before implementation to predict the full impact of the agreement and to predict the exact value of contracts that will be concluded with foreign suppliers. One source of concern in Canada, which is less likely to be a problem in the United States, the EC, and Japan, is the pattern of tendering by multinational firms. It may transpire that multinational firms with subsidiaries in Canada will adopt policies tending to promote sales to D.S.S. by the foreign-based parent rather than the Canadian-based subsidiary. But it is too early to predict whether this will in fact happen.

If the short-term assessment of the significance of the agreement must be viewed with caution, it may be that the long-term outlook for elimination of barriers to foreign access to government procurement is brighter. If it is possible to sustain the general momentum achieved in the Tokyo Round towards the gradual elimination of non-tariff barriers, then the extensive institutional mechanisms of the agreement may well be able to carry forward and foster the process of change. The procedures for consultation, negotiation, and dispute settlement and especially the Government Procurement Committee are designed to maintain an ongoing process of change, and it is conceivable that they may come to play the same quasi-institutional role that the negotiation and dispute settlement procedures under the GATT have played with respect to the latter agreement. For this to happen, it will be necessary for foreign suppliers to derive real economic advantage from the agreement and for them to expect increased advantage from increased access. If this happens, the process of expansion of coverage under the agreement may well achieve a dynamic of its own over the next decade. But it is too early to predict whether this will in fact occur.

4. Conclusions

At this point it is not easy to assess the full impact of the agreement upon Canada nor upon its principal trading partners.[107] However the following general assessment is proposed:

1. The government of Canada will be in a position to implement its commitments by 1 January 1981, and is well advanced now.
2. The immediate economic advantages that Canada will concede to other parties do not appear to be great, given the wide exemptions, limited coverage, and complete exclusion of provincial governments.
3. The agreement does not provide Canadian firms access to some foreign procurement markets, such as heavy electrical and transportation equipment, of particular interest to them. There is some concern about the tendering policies to be adopted by multinational companies having Canadian-based subsidiaries.
4. It is not easy to calculate the true value of Canada's "offer," since no public calculation exists as to its component elements.
5. There is little doubt as to the willingness of the government of Canada to implement the agreement, but it is by no means clear that the government desires to open up Canadian procurement markets further to foreign suppliers.
6. Some initial practical difficulties lie in the way of would-be foreign suppliers in obtaining access to the new markets opened to them by the government of Canada. The same will be true for Canadians seeking access to foreign markets.
7. Given the above, it would seem too early to assess the economic advantages of the agreement. By 1 January 1982, it will be much easier to assess the value of the Canadian offer.
8. The policies of the government of Canada will be influenced by the manner in which other parties implement the agreement. Reciprocity will be of the essence, except in so far as LDC's are concerned. Should reciprocity not be forthcoming, the agreement could well founder.
9. It is possible that the advantages of the agreement, like those of the GATT itself, lie outside the immediate economic advantages that may have been conceded by the parties. The agreement creates a framework for consultation, dispute settlement, and future negotiation towards the progressive lowering of this non-tariff barrier and must be judged in this light.

Notes

[*] The views expressed in this essay are those of the author alone. The author wishes to thank officials of the Departments of Industry, Trade and Commerce, Finance, and Supply and Services for their very kind assistance in preparing this essay.

[1] Initialed at Geneva, 12 April 1979, by twenty-three states, including the EC, Japan, the United States, the Nordic states, and Canada. MTN/NTM/W/211/Rev. 2, *International Legal Materials* 18 (1979): 1052–78 (hereinafter the "agreement"). The United States signed subject to a caveat concerning settlement of certain issues relating to access to Japanese procurement markets. Canada is not yet a Party. Signature by Canada has been authorized by Order in Council P.C. 1979–3298, 6 December 1979 but this had not yet been completed as of 15 November 1980.

[2] The process will begin on 1 January 1981 and is subject to review within three years, see Articles IX.3 and IX.6.

[3] In 1978–79, total federal procurement expenditures were above $10 billion, of which D.S.S. spent $2.41 billion and $300 million was paid to foreign-based suppliers.

[4] Author's estimate.

[5] Buy-American Act, 41 U.S.C. 10a *et seq* (as amended), Trade Agreements Act, 93 STAT 144, 19 U.S.C. 2501 sec. 301 *et seq.*; France, Code des marchés publics, D.64.729, 17 July 1964 (as amended), Décret d.73-431, 14 March 1973.

[6] Klaus Stegemann and Keith Acheson, in their excellent review of "Canadian Government Purchasing Policy," *Journal of World Trade Law* 6 (1972): 442–78, list the following justifications given for Canadian policy in 1972: maintenance of high employment, defence considerations, reinforcing international preference systems, development of new manufacturing industries in Canada, reduction of regional disparities, encouragement of small business, Canadian ownership, and *containment of inflation*. See also Klaus Stegemann, *Canadian Non-Tariff Barriers To Trade* (Montreal: Private Planning Association, Canadian Economic Policy Committee, 1973), Chapter 3.

[7] Department of Supply and Services, Inter-Program Planning Branch. For a fuller description of present policy see Part 3(A) below.

[8] See notes 5 and 15.

[9] Although it might have been caught partially by the general language of Articles 46 and 53. Havana Charter for an International Trade Organization, Department of State, Publication 3206, Commercial Policy Series 114. September 1948.

[10] GATT, Article III. 8(a). It is however possible to argue that Article I applies.

[11] 1961 Canada Treaty Series No. 5. See also G. Rosenbluth, *The Canadian Economy and Disarmament* (Toronto: Macmillan, 1967).

[12] Organisation for Economic Co-operation and Development, *Government Purchasing in Europe, North America and Japan: Regulations and Procedures* (Paris: OECD, 1966).

[13] *Public Purchasing in the Common Market*, Report to the European Communities SEC (74), 6 November 1974.

[14] Directive 77/62 EEC, 15.1.77., *Official Journal of the European Communities* L. 13/1.

[15] Organisation for Economic Co-operation and Development, Trade Committee, *Government Purchasing, Regulations and Procedures of OECD Member Countries* (Paris: OECD, 1976).

[16] Organisation for Economic Co-operation and Development, Trade Committee, *Government Purchasing, Draft Instrument on Government Purchasing Policies Procedures and Practices*, TC (76) 21 (Paris: OECD, 26 October 1976).

[17] Canada introduced a completely redrafted text, based upon the OECD guide-lines.

[18] The U.S. offer was calculated at $13 billion, the EC offer at $11–12, and Japan's offer at $10 billion; the Canadian offer was estimated to be worth $1.3 billion.

[19] "Agreement on Government Procurement," Notes for a Meeting of Ambassador Warren with the Canadian Manufacturers Association, Toronto, 2 August 1979.

[20] Agreement, Article II.1(b).

[21] *Ex maiore cautela* it is stated that these rights do not apply to customs duties, Article II.2.

[22] Such as quality, performance, safety and dimensions, testing and test-methods, symbols, technology, and packaging, etc., Article IV.1.

[23] *Ibid.*

[24] Agreement, Article IV.2.

[25] *Ibid.*, Article IV.3.

[26] GATT Agreement on Technical Barriers to Trade, MTN/NTM/W/192/Rev. 5, 29 March 1979, *International Legal Materials* 18 (1979): 1079–1111.

[27] Agreement, Article V.2. Canadian negotiators laid particular emphasis upon this principle.

[28] *Ibid.*, Article V.2(b).

[29] *Ibid.*, Article V.2(d).

[30] *Ibid.*, Article V.3.

[31] In the case of Canada: *Canada Gazette*; United States: *Commerce Business Daily*; Japan: *Kanpo*; EC: *Official Journal of the E.C.*; France: *O.J.E.C.* and *Bulletin officiel des annonces des marchés publics*, etc.

[32] Agreement, Article V.4.

[33] *Ibid.*, Article V.5.

[34] *Ibid.*, Article V.6(a).

[35] *Ibid.*, Article V.6(c).

[36] *Ibid.*, Article V.9(a).

[37] *Ibid.*, Article V.10.

[38] *Ibid.*, Article V.12(h).

[39] *Ibid.*, Article V.13(a)(b).

[40] *Ibid.*, Article V.14(a).

[41] *Ibid.*, Article V.14(d).

[42] *Ibid.*

[43] *Ibid.*, Article VI.4.

[44] *Ibid.*, Article V.14(g).

[45] *Ibid.*, Article V.14(h).

[46] The offset issue arises particularly in the area of defence contracts that are not covered by the agreement.

[47] Agreement, Articles V.15 and 16. Single tendering is envisaged when (*a*) collusion is feared, (*b*) respecting works of art or where exclusive patent of copyright considerations prevail, (*c*) in cases of extreme urgency, (*d*) for additional deliveries, and (*e*) for design of a prototype. Again there appears to be considerable discretion allowed.

[48] *Ibid.*, Article I.1(b). $220 000 CDN at current exchange rates (April 1980).

[49] Which forms part of the agreement.

[50] Department of Supply and Services. Information provided to the author during interviews with departmental officers.

[51] *Consolidated Regulations of Canada, 1978*, c. 701 (hereinafter *G.C. Regs.*).

[52] *Ibid*. The Royal Canadian Mounted Police are subject to the same rule.

[53] In the hope of changing this situation Canada has made the implementation of certain of its tariff concessions conditional upon these items and the relevant foreign purchasing entities being brought under the agreement.

[54] Notes for a Meeting of Ambassador Warren with the Canadian Manufacturers Association, Toronto, 2 August 1979, p. 1.

[55] *Ibid*., p. 5.

[56] The Hong Kong, Jamaica, and Singapore lists contain only 1 entity, that of India 4; the Republic of Korea lists 1 entity and 6 categories of goods; Nigeria lists 1 entity and 10 types of goods.

[57] Agreement, Article VI.9. Judgement as to the nationality of a supplier will be complex in the case of multinational companies; the country of origin of a product made of components manufactured in different countries may pose similar problems.

[58] *Ibid*., Article VII. 3 and 4.

[59] *Ibid*., Article VII.9.

[60] *Ibid*., Article VII.10.

[61] *Ibid*., Article VII.11.

[62] *Ibid*., Article VII.14.

[63] Recognition of special difficulties relating to their balance of payments, the need to establish and maintain domestic industries; inclusion by developed countries of entities of special interest to LDC's; right to withdraw entities or products included in LDC lists and a broader right of LDC's to modify their lists, as well as a commitment to provide technical assistance in dealing with developed country procurement requirements should this assistance be requested.

[64] Agreement, Article IX.3.

[65] *Ibid*., Article IX.4.

[66] *Ibid*., Article IX.1.

[67] *Ibid*., Article IX.5(b).

[68] *Ibid*., Article IX.6.

[69] *Ibid*., Article IX.2.

[70] *Ibid*., Article IX.8.

[71] See note 5.

[72] *Ibid*.

[73] R.S.C. 1970, Chapter F−10.

[74] R.S.C. 1970, Chapter S−18.

[75] *Ibid*., section 5(3).

[76] R.S.C. 1970, Chapter P−38.

[77] R.S.C. 1970, Chapter D−2.

[78] *Ibid*., section 8(2).

[79] This section authorizes the minister to "... organize, mobilize and conserve the resources of Canada. . . ."

[80] 1961 Canada Treaty Series No. 5.

[81] These laws and policies are well reviewed by Stegemann and Acheson, *op. cit*. Similarly the Fair Wages and Hours of Labour Act, R.S.C. 1970, Chapter L−3 authorizes the minister of labour to set wage standards for workers on government contracts. This limited activity would seem to have only marginal impact upon the operation of the agreement upon the government of Canada.

[82] *G.C. Regs*.

[83] Treasury Board, Administrative Policy Manual, c. 310 (hereinafter "T.B. Admin. Policy, c. 310").

[84] Treasury Board, Administrative Policy Manual, c. 305 (hereinafter "T.B. Admin. Policy, c. 305").

[85] This document is not in the public domain; however, D.S.S. officers are prepared to explain its application to specific issues and the thrust of its policies to interested companies and scholars.

[86] Under $15 000 or under $50 000 if 2 tenders are received. *G.C. Regs*., section 15.

[87] Under $25 000 or under $50 000 with 2 valid tenders. *G.C. Regs*., section 20.

[88] Under $15 000 or under $150 000 with 2 valid tenders. *G.C. Regs*., section 13.

[89] *G.C. Regs*., section 17; $500 000 without tender.

[90] *Ibid*., section 8.

[91] *Ibid*., section 9.

[92] *Ibid*., section 8.

[93] T.B. Admin. Policy, c. 310, 16.

[94] *Ibid*., 14, there is no guidance as to the nature of national policies and objectives.

[95] *Ibid*., 27.

[96] The only explicit recognition of the possibility of foreign suppliers in this directive is the references to foreign bankruptcies, 47, and exchange rates, 51.

[97] T.B.Admin. Policy, c. 305, adopted in April 1980.

[98] Involving a "PRM Committee" for each such proposed contract and subject to the general direction of the "Procurement Policy Advisory Committee."

[99] Board of Economic Development Ministers, "Background Paper on the Use of Federal Purchasing in Support of Industrial Development," Ottawa, April 1979.

[100] T.B.Admin. Policy, c. 305, 5.

[101] The author assumes sole responsibility for this assessment.

[102] In 1978−79, 87 per cent of D.S.S. procurement was met by Canadian-based suppliers. Of the 13 per cent, 9 per cent went to the United States, 1 per cent to the United Kingdom, and 3 per cent to all others.

[103] Department of Supply and Services.

[104] See note 3.

[105] This amount may have to be reduced if the $1 billion includes any of the $300 million paid to foreign-based suppliers in 1978−79. It is possible that most of the $300 million was spent on military procurement. However, since the exact elements of the offer are confidential, it is not possible to make a more exact estimate. Nor can it be known exactly what goods will be purchased from foreign suppliers. Foreign suppliers are being offered an opportunity to tender; they are not guaranteed sales worth $1 billion.

[106] See note 101.

[107] This essay is written largely from the import perspective. For an assessment of the general trade policy perspective, see G. Denis, "The International Agreement on Government Procurement," Notes for presentation at the Second Annual Conference on International Trade and Investment, sponsored by the Federal Bar Association, 23–24 October 1980, Washington, D.C. See also Morton Pomeranz, "Toward a New International Order in Government Procurement," *Law and Policy in International Business* 11 (1979): 1263–1300; and David V. Anthony and Carol K. Hagerty, "Cautious Optimism as a Guide to Foreign Government Procurement," *Law and Policy in International Business* 11 (1979): 1301–43.

Product Standards and Non-Tariff Obstacles: The GATT Code on Technical Barriers to Trade

9

by
Ivan Bernier

1. Introduction

Standards, as the term is understood in the ordinary language of international trade, refer to various kinds of technical specifications that characterize a product in terms of its quality, performance, safety, or physical dimensions.[1] In legal usage, a distinction is generally made between standards as such, with which compliance is not mandatory, and technical regulations, with which compliance is mandatory.[2] In both cases, however, the nature of the problems raised, as far as international trade is concerned, is essentially the same.

A. The Nature of the Problems Raised by Standards and Technical Regulations in International Trade

The various problems raised by standards and technical regulations in international trade can be grouped according to the type of solutions that they require. First of all, there is the case where product standards and technical regulations are used, directly or indirectly, as a protectionist tool: such interventions are obviously to be condemned, but the difficulty is to prove the specific intent to discriminate. This type of problem corresponds largely to the traditional field of intervention of the GATT. Secondly, there is the case where standards, well intentioned in themselves, have nevertheless the effect of creating obstacles to international trade simply because they differ from one country to another: the problem here is to devise an appropriate formula in order to harmonize diverging national standards and technical regulations. This second type of problem goes beyond the traditional field of GATT concern but is now the object of its attention. Finally, there is the case where standards are used as a means of grasping a bigger share of world trade through dissemination of a particular technology: the danger here is that a state or a group of states may be tempted to unduly influence decisions arrived at in international standardizing bodies, particularly if international standards become the generally accepted method for harmonizing national standards. This last type of problem does not yet appear to have received all the attention of the GATT signatories that it requires.

Standards or technical regulations may be considered as a protectionist device if they are intentionally formulated to exclude or discourage foreign imports, or if the certification procedure that accompanies such standards is used as a means of slowing down or preventing foreign imports. Charges of intentional protectionism between Contracting Parties to the GATT are relatively rare: the reason, as already seen, is that specific intent in a given case is always difficult to prove when health or security is the alleged motive behind a standard. The usual arguments put forward in support of a charge of protectionism in the case of standards or technical regulations have to do with their unequal impact on domestic and foreign products and their excessive severity. As far as approbation or certification procedures are concerned, protectionist charges habitually focus on the excessive length of time and the cost of such procedures; in the exceptional case, as in the notification made by Canada, the EEC, and the Nordic countries concerning security standards for life jackets in the United States, outright refusal to consider foreign products will be alleged.[3]

More often than not, however, Contracting Parties to the GATT will abstain from throwing out protectionist accusations, preferring to stress that divergences among countries in their standards or technical regulations represent a needless distortion of trade and should be eliminated. In the GATT catalogue of non-tariff barriers, one can see numerous instances of such situations. A good example is the problem of safety standards for vehicles. In their notification against the United States, both Japan and the EEC have taken pains to emphasize that the real problem is one of international harmonization of national standards and regulations.[4] But the difficulty of course is to decide which standard will become the accepted international norm or the common standard. The United States, for instance, has long complained about Canadian norms relating to the size of food cans: because the Canadian sizes differed from those in use in the United States, they had the effect of preventing the importation into Canada of American canned food.[5] Now whatever the consumer protection rationale for this position (the argument of the Canadian government was that a limited number of standard sizes makes it easier for the consumer to compare prices), one must accept that states are free to act as they wish in this respect. Therefore, Canada was perfectly right in retorting that there was no reason why it should be made to adjust, and not the United States. One could always argue that the cost of changing would be smaller for Canada than for the United States. But then this line of reasoning would apply in almost all cases of divergent standards, and Canada might as well abdicate its responsibilities in the field of standards and technical regulations. Since this is a proposition that no state can accept, one can see that harmonization at the international level can only proceed through the voluntary acceptance of national standards that are recognized world-wide or through the adoption of international standards. The obvious risk with the first method is that the use of one national standard may lead to the use of other related national standards and a national technology may thus take hold.[6] The second method from that point of view will easily appear safer; but it is not devoid of danger itself.

The fact is that national standardizing organizations tend to adopt a double attitude concerning their participation in the work of such international standardizing bodies as the ISO (International Organization for Standardization) or the IEC (International Electrotechnical Commission). On the one hand, they try to make sure that domestic products will meet the standards agreed upon by making appropriate representations in the technical committees that are of greatest interest to their producers. Up until recently, this was the basic attitude of the United States and to some extent of Canada.[7] On the other hand, national standardizing organizations will try to promote openly their own norms as a basis for international standards. This is particularly the case of West European countries which, through the work of regional standardizing bodies such as the CEN (European Standards Coordinating Committee) and the CENELEC (a similar committee for electrical and electronic standards), both composed of Common Market and European Free Trade Association countries, are able to have their standards introduced as an ISO or IEC standard. As a former president of ASTM, the most important standards writing organization of the United States, explained in 1977:

> Once CEN/CENELEC countries have agreed on a harmonization document they are able to have it introduced as a proposal for an ISO or IEC standard. Usually all or most member countries will support the document so strongly that the United States and other countries will find it hard to make many changes in the document. There is much criticism that this is a form of bloc voting that prevents fair consideration of all views. Since all the CEN/CENELEC countries are members of ISO and IEC they certainly have tremendous voting strength.[8]

Thus, behind the nice talk on the necessity of developing international standards, one can discern a new conflict taking shape between the great trading blocs. What is at stake, however, is not so much trade between developed countries — the relative lack of impact of existing international standards testifies that beyond their necessarily general language, nations are still able to protect their domestic markets through local deviations, but rather trade between developed and developing countries, which is perceived as offering vast possibilities for the future. The best evidence of this is that, notwithstanding the efforts of the ISO, individual states are scouring the world trying to promote their own national standards. Be it France in China, India and Canada in the Carribean, or Canada, the United States, France, Germany, and England in the Far East, the basic attitude is the same: developing countries offer new markets, and their adoption of particular national standards offers a practical way of penetrating those markets, while denying access to foreign suppliers that employ divergent standards.

B. The History of the GATT Code on Standards

Prior to the recently concluded Agreement on Technical Barriers to Trade, the main provisions of the General Agreement that dealt with the problems raised previously were Article III, paragraph 1 and Article XX.[9] Article III, paragraph 1, states:

> ... laws, regulations and requirements affecting the ... use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

This provision, however, which appears to prevent recourse to technical specifications for protectionist motives, must be read in conjunction with Article XX, which states:

> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:
>
> . . . . .
>
> (b) necessary to protect human, animal or plant life or health.

Unfortunately, as the difference between what is in truth a health or safety measure and what amounts in practice to a protectionist device is rarely obvious, these two provisions have not proved very effective as a means of preventing the erection of barriers to trade in the form of standards or technical regulations.[10] If one considers, moreover, that they do not deal at all with the important problem of incompatibility of norms, then it is obvious that something had to be done to alleviate the general problems raised by standards and technical regulations.

The first step in that direction was the creation by the GATT, in November 1967, of the Committee on Trade in Industrial Products whose immediate mandate, in the aftermath of the Kennedy Round, was to draw up an inventory of non-tariff barriers.[11] The Committee, according to the instructions received, requested the Contracting

Parties to notify the GATT Secretariat of the various non-tariff barriers that they wished to see included in the catalogue. Soon it became obvious that many of those barriers concerned standards and technical regulations, and accordingly a further study of the question was entrusted to one of the five working groups set up by the Committee to analyse the various complaints received and to prepare solutions *ad referendum*. Taking advantage of studies made by other organizations, the standards group was able, as early as June 1973, to present a project of code that, notwithstanding certain points of disagreement, met with fairly wide approval among its members.[12] This project, subsequently transmitted to the various national administrations, was used as a basis for the discussion of the problem of technical obstacles to trade during the Tokyo Round of negotiations.

The negotiations moved into their active phase in 1975. At an early stage, it was agreed to include in the proposed code on standards provisions on packaging, marking, and labelling requirements. Between 1976 and 1978, further agreement was reached on such questions as the exact definitions to be employed in the texts, the regional quality assurance system, the method of enforcement, and the level of obligation to be assumed by the Contracting Parties. Towards the end of 1978, it was decided to incorporate in the Draft Code on Technical Barriers to Trade a number of amendments designed to make it applicable to agricultural products.[13] Finally, after a few minor changes, the final text of the code was approved in March 1979.[14]

It remains to be seen how this agreement, which entered into force in January 1980 for the Contracting Parties that have ratified it, including Canada and the United States, deals with the problems identified previously. In the next section, the general structure of the agreement will be outlined, followed by an analysis of its more significant aspects. The last section will examine some of the problems left unresolved by the agreement.

2. The Agreement on Technical Barriers to Trade

A. The General Structure of the Agreement

The agreement is composed essentially of a preamble, fifteen articles, and three annexes. The preamble simply states that international standards are desirable and should be encouraged in order to prevent unnecessary obstacles to international trade; national measures for the protection of health, environment, and security are expressly recognized as a valid concern of states, provided that they are not used as a means of arbitrary or unjustifiable discrimination between countries. The preamble also notes " . . . the contribution which international standardization can make to the transfer of technology from developed to developing countries."

The fifteen articles of the agreement follow a fairly simple pattern. The first one, entitled "General Provisions," enunciates the fundamental rules for interpretation of the agreement. The next thirteen articles deal successively with the substantive problems concerning technical regulations and standards as such, the specific needs of developing countries, and finally the method of dispute settlement. Regarding technical regulations and standards as such, the agreement deals in turn with their preparation, adoption, and application, the definition of test methods, and finally the formulation and operation of certification systems. The last article of the agreement contains the usual dispositions regarding acceptance and accession, reservations, entry into force, review, amendments, and so forth.

The three annexes to the agreement constitute an integral part thereof. Annex 1 completes Article 1 with a list of terms and their definition for the specific purposes of the agreement. The basis for such definitions is the wording of the corresponding Economic Commission for Europe/International Organization for Standardization definition, more or less amended in order to exclude services, codes of practices, and various normative elements beyond the scope of the agreement. Annex 2 and Annex 3 elaborate the procedures that apply to the technical expert groups and panels provided for in Articles 14.10 and 14.16 of the agreement; their essential content will be examined below together with the dispute settlement procedure.

B. The Level of Obligation

Coming back to the substantive obligations assumed by the parties under Articles 2 to 10 inclusively, the most striking feature of the agreement, at first sight, is the fundamental distinction that is made between technical regulations and standards that originate from central government bodies and those that originate from local government bodies and from non-governmental bodies. This distinctive feature corresponds to one of the most stubborn problems met by the Contracting Parties during the negotiations on this agreement: the problem of the level of obligation to be assumed by the parties.

In an international economic treaty such as the GATT, or such as the various codes adopted under the aegis of the GATT, one of the most fundamental principles is that of reciprocity. In the case of federal states, it is well known that their internal division of powers prevents them from accepting rigid obligations in fields where their member states are competent.[15] Since constituent states in many federations, such as Canada or the United States, possess the power to adopt technical regulations and standards, it is easy to see the kind of problem that the Contracting Parties had to face during the negotiations. The fact that the central authorities are competent in many instances to override the contrary interventions of their member states does not necessarily solve the difficulty, for political reasons may often prevent them from doing so. Even inside a centralized country, a balance of rights and obligations is hard to establish because of the differing powers conferred on their central authorities. As for standards originating from non-governmental bodies, the problem is similar to a large extent. When private standardization is the rule in a country, direct governmental intervention in this field may be politically unpopular and difficult to realize in practice. In such cases, therefore, the states concerned will prefer to assume a "best endeavours" obligation rather than a firm obligation of compliance. But for states that are legally competent to go beyond that, such an attitude of course is hardly compatible with the principle of reciprocity.

In view of this, one is not surprised to find that during the negotiations, a country such as Japan, where private norms are practically more important than governmental regulations, was asking for a first level of obligation for central and local government regulations and a second level of obligation ("best endeavours") for non-governmental standards. As for the EEC, caught between the informality of the Japanese system and the complexity of the American system, but faced at the same time with its own problems of harmonization, its apparent aim was to obtain a first level of obligation for central government regulations as well as private standards, and a second level of obligation where only local governments were concerned. The United States and Canada, finally, faced with the dual problem of local governments and a largely non-governmental standardization system, were naturally in favour of a first level of obligation for central government entities only, but included in this quasi-governmental entities.[16]

The solution eventually adopted in the code, as is often the case in such situations, builds upon the smallest common denominator, that is, a first level of obligation for central government interventions, and a "best endeavours" obligation for the local government bodies and non-governmental bodies. Thus, according to Article 3, "Parties shall take such reasonable measures as may be available to them to ensure that local government bodies within their territories comply with the obligations of Article 2 . . ."; these obligations are those assumed by the parties with regard to the preparation, adoption, and application of technical regulations and standards by central government bodies. Similarly, according to Article 4, "Parties shall take such reasonable measures as may be available to them to ensure that non-governmental bodies within their territories comply with the provisions of Article 2. . . ." The same approach is used, as mentioned previously, for the other fundamental obligations assumed by the parties under Article 5 (determination of conformity with technical regulations or standards by central government bodies), Article 7 (certification systems operated by central government bodies), and Article 10 (information about technical regulations, standards, and certification systems).

A key issue is the meaning to be assigned to the expression " . . . take such reasonable measures as may be available to them to ensure that. . . ." The wording used, one must point out, is not new to the GATT. As a matter of fact, it reproduces exactly the wording of Article XXIV (12) of the General Agreement itself, which reads as follows:

> Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory.

Unfortunately, this clause, which can be described as a "federal state" clause, is not devoid of ambiguity. The problem is that the obligation to intervene is made dependent upon two variables, one of which, availability, is objective, while the other one, reasonableness, is largely subjective. Can the central authorities of a federal state refuse to intervene in a situation where they have the power to do so but find it politically difficult? The answer is certainly not obvious.

The only guidance we have on the meaning of Article XXIV (12) is an interpretative note annexed to Article III (1), which reads as follows:

> The application of paragraph 1 to internal taxes imposed by local governments and authorities within the territory of a contracting party is subject to the provisions of the final paragraph of Article XXIV. The term "reasonable measures" in the last-mentioned paragraph would not require, for example, the repeal of existing national legislation authorizing local governments to impose internal taxes which, although technically inconsistent with the letter of Article III, are not in fact inconsistent with its spirit, if such repeal would result in a serious financial hardship for the local governments or authorities concerned. With regard to taxation by local governments or authorities which is inconsistent with both the letter and spirit of Article III, the term "reasonable measures" would permit a contracting party to eliminate the inconsistent taxation gradually over a transition period, if abrupt action would create serious administrative and financial difficulties.

Notwithstanding the contrary opinion of John Jackson,[17] this interpretative note contains a concrete application of Article XXIV (12) and, from that point of view, provides an illuminating insight into its working. What can be deducted from the note is the legitimacy of a balance-of-interests approach whereby the essential objectives of the

GATT are preserved but at the same time the political difficulties of the Contracting Parties are taken into consideration.

Should the various "best endeavours" clauses of the Agreement on Technical Barriers to Trade be interpreted in the same way? The code's exact reproduction of the wording of Article XXIV (12) of the General Agreement naturally militates in favour of this view. But there is a better argument still to be found in the code on standards itself. According to Article 14.24, ". . . where a Party considers that another Party has not achieved satisfactory results under Articles 3, 4, 6, 8 and 9 [which are those that contain a "best endeavours" clause] and its trade interests are significantly affected . . .," it can make use of the dispute settlement provisions of the agreement. And the article goes on to say: "In this respect, such results shall be equivalent to those envisaged in Articles 2, 5 and 7 as if the body in question were a Party." What this means in practice is that the "best endeavours" clauses allow only for a limited derogation from the agreement and that if substantial obligations are contravened, corrective measures will be required or else retaliation will follow. In this way, the fundamental principle of reciprocity is respected while some room for manoeuvre is left to those states that need it.

Before leaving this question, it may be interesting to consider briefly to what extent federal states such as the United States and Canada may be prevented from complying fully with the Agreement on Technical Barriers to Trade. In both states, it is a fact that the component units have retained the power to adopt standards and technical regulations for the purpose of local trade, especially where consumer protection is involved. In both states also, the central government is constitutionally authorized to enter the field of standards and technical regulations where interstate or international trade is concerned, or where other federal powers are involved such as, in Canada, the criminal law power. Finally, where a conflict arises, federal law in both states prevails. The only differences between the United States and Canada have to do with the scope of the interstate trade power and the treaty implementing power of the federal government. Regarding the interstate trade power, the best way, perhaps, to describe the difference is to say that while the United States Supreme Court has adopted a functional view of interstate trade, the Canadian Supreme Court is still struggling with a material approach that pretends to distinguish objectively between what is local trade and what is interstate or international trade.[18] The result is that the federal government of the United States has definitely more leeway when it acts under the interstate commerce power than the federal government of Canada, which must always take care not to encroach unnecessarily on local trade. As for the treaty implementing power, the difference between the United States and Canada is that in the former, under Article VI of the Constitution, treaties are the "supreme law of the land" and hence prevail over inconsistent state legislation, while in the latter, treaty implementation follows the constitutional division of competence, the federal government and the provincial governments each acting in their own field.[19]

How are these differing constitutional arrangements likely to affect the implementation of the GATT Agreement on Technical Barriers to Trade? In both states, if the component units, the local government bodies to use the terminology of the agreement, comply with the provisions of the code, no problem arises. If they refuse to do so, however, the federal government in both states has the power to intervene and apparently would do so; but whereas this is quite clear in the eyes of the United States government, the same proposition attracts some reserve on the part of the Canadian government. In the United States, the Senate Report of the Committee on Finance on the Trade Agreements Act of 1979 is quite clear on the subject. Concerning state and private standards-related activities in particular, it says:

> The committee is cognizant of the fact that the agreement does not exempt the trade restrictive standards-related activities of non-central governmental bodies although such bodies are not bound directly. In the event that such a non-Federal standard, test method or certification system is found by the Committee on Technical Barriers to Trade to be an unnecessary obstacle to trade in violation of the agreement, there is existing legal authority under its power to regulate interstate and foreign commerce to obtain a modification if the Executive decides to seek a change. Therefore, no additional authority is needed or created in title IV to enable the Federal Government to fulfill its agreement obligations with respect to non-central government bodies.[20]

In the case of Canada, a similar document, but of a purely administrative nature, admits that the federal government, in order to respect its "best endeavours" obligation, might have to use all the legislative powers that are at its disposal.[21] But then it goes on to say that technical regulations and standards which apply to products that do not enter the flow of interprovincial or international trade may well be beyond the reach of federal legislation and, therefore, that the consent of the provinces should be obtained. This last view of the federal power over interprovincial and international trade, however, appears to be a rather narrow interpretation of Article 91(2) of the Canadian Constitution. As Lord Tomlin said in *Re Fisheries Act, 1914*, and as was reaffirmed more recently in *Regina* v. *Klassen*, a case dealing with the trade power:

> It is within the competence of the Dominion Parliament to provide for matters which, though otherwise within the legislative compe-

> tence of the provincial legislature, are necessarily incidental to effective legislation by the Parliament of the Dominion upon a subject of legislation expressly enumerated in s. 91.[22]

This leaves as the only question to decide whether the federal Parliament, in implementing the Agreement on Technical Barriers to Trade, is in pith and substance dealing with international trade. If the answer is yes, then the legislation is valid.

C. The Fundamental Obligations Assumed Under the Agreement

As mentioned before, the fundamental obligations assumed by the parties under the agreement turn around four areas of activities: first, the preparation, adoption, and application of technical regulations and standards; secondly, the testing methods; thirdly, the certification systems; and fourthly, information. Notwithstanding the fact that specific problems are considered in each of those four areas, there is a certain similarity in the legal approaches used in order to resolve these problems. As we shall see, the common pattern is to start by banning voluntary discrimination, and then to impose a positive obligation to adopt measures designed to eliminate involuntary obstacles to international trade.

In regard to the preparation, adoption, and application of technical regulations and standards, Article 2.1 of the agreement starts with the statement that parties shall ensure that nothing is done "with a view to creating obstacles to international trade"; and in order to impart a concrete meaning to that obligation, parties are asked to grant most-favoured-nation treatment as well as national treatment ". . . to like products originating in any other country in relation to such technical regulations and standards." Perhaps because there is nothing really new in this — after all, Articles III and XX of the General Agreement already covered such situations — Article 2.1 ends with what is in fact an introduction to the nine remaining paragraphs, that is, a statement of the positive duty of parties to prevent unnecessary obstacles to international trade.

The method adopted by the agreement in order to realize this objective is to require the parties, first, to adopt international standards wherever possible and, secondly, where this is not possible because international standards do not exist or are inappropriate, to follow a procedure whereby advance notice is given of the intent to adopt a technical regulation or standard, reasonable time allowed for other parties to make comments and, finally, due attention paid to thosecomments. This basic approach is complemented by a number of accessory provisions that elaborate on the duty of parties to participate as fully as possible in international standardizing bodies, on the procedure to follow when urgency makes it impossible to respect the step-by-step approach for the adoption of a national standard or technical regulation, on the duty to publish such standards and technical regulations promptly, and to allow a reasonable interval between the publication of a technical regulation and its entry into force, and on the duties of parties as members of regional standardizing bodies.

International standards are thus the corner-stone of the new system for eliminating unnecessary obstacles to international trade. What is proposed in fact is the development of a common technical language for describing the functional characteristics of goods and products.[23] But this is not an easy task. If this technical language is too closely identified with a state or a group of states, the danger is that it may not be accepted by other countries. Obviously aware of this problem, the Contracting Parties have taken care, in Article 2.3 of the agreement, to specify that:

> With a view to harmonizing technical regulations or standards on as wide a basis as possible, Parties shall play a full part within the limits of their resources in the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations or standards.

Considering, however, that there are already close to two hundred technical committees in existence in the ISO alone, and that many more such committees are bound to be created in the future, one must realize that full participation in practice will be open solely to a few powerful states.

Assuming nevertheless that this is a satisfactory solution, and that more and more states will participate actively in this international standardizing process, there is an additional problem. As already suggested previously, there is evidence that many states, if not all, participate in such activities primarily to protect their economic interests.[24] This being the case,the standards adopted at the international level tend to embody the smallest common denominator and are sometimes so general that they lose much of their significance. In such circumstances, few states will refuse to use them as a basis for their technical regulations and standards; but they may well feel obliged at some point to complement them with specifications of their own. This already happens in practice, and if nothing is done to prevent the generalization of this attitude, then it will be the end of the common language idea.[25]

However, the agreement does not rely exclusively on international standards in order to eliminate unnecessary obstacles to international trade that may result from technical regulations and standards. The advance notice procedure imposed by Article 2 on those parties that wish to adopt a distinct national standard may be a second-best solution, but its utility cannot be denied. The main difficulty with this procedure has to do with its administrative complexity. Its initial consequence will be to cause delays in the adoption of national standards and technical regulations: how well this will be accepted by governmental and non-governmental standardizing bodies remains to be seen. Furthermore, the quantity of information required for standards decisions will be multiplied manyfold: if each party is to take advantage of the opportunity provided by the agreement to comment on standards of other nations, it will have to face up to the added cost involved. Translation alone in this respect may be a substantial financial burden.[26] In order to avoid duplication of work, it might be a good idea to have the GATT Secretariat set up a central translation service specialized in technical specifications.[27] Beyond such administrative difficulties, however, one must realize that the essential condition for the success of this procedure is the good faith of the parties. Since such good faith must be assumed at the outset, it remains to be seen how the procedure will work out in practice.

The second area of activity envisaged by the code concerns testing methods. Article 5 begins with the assertion that in cases where a positive assurance is required that products conform with technical regulations or standards, national treatment should be granted to foreign products as far as concerns the conditions, methods, and administrative procedures for such tests. This duty not to discriminate is completed by additional dispositions concerning equitable treatment for fees, the possibility of corrective action, the sitting of testing facilities, and the confidentiality of information, the basic idea in each case being that obstacles to foreign imports should be eliminated wherever possible. The second part of Article 5 is more dynamic and therefore raises more serious problems. Parties are asked to accept "... test results, certificates or marks of conformity issued by relevant bodies in the territories of other Parties ... even when the test methods differ from their own." Naturally, the party concerned must be satisfied that the methods employed provide a sufficient means of determining conformity with the relevant technical regulations or standards. However, even with this last proviso and even with the option that the parties retain of carrying out reasonable spot checks within their territories, there are indications that this specific requirement may raise some serious implementation problems. First of all, one must reckon with the fact that standards usually do not allow for alternate test methods; therefore, a change of attitude on this subject will be necessary. Secondly, an international laboratory (testing organization) accreditation programme will obviously be needed; this remains to be done.[28] Finally, declarations of conformity by quality assurance bodies in other countries may clash head-on with a new problem that is coming to the fore these days, particularly in the United States and in England — the problem of standards liability.[29] This, unfortunately, is a development that appears hardly favourable to a generalized extension of foreign testing. Until this problem is clarified, it may well be that Article 5.2 of the agreement will remain ineffective.

The agreement's third area of concern has to do with certification systems. Once again, parties are asked, in Article 7, to ensure that certification systems "are not formulated or applied with a view to creating obstacles to international trade," and that "neither such certification systems themselves nor their application have the effect of creating unnecessary obstacles to international trade." The duty not to discriminate finds its concrete application in the obligation to grant most-favoured-nation treatment as well as national treatment to foreign suppliers, whereas the duty to contribute to the elimination of unnecessary obstacles to international trade takes the form of an engagement not to introduce certification systems without prior notification to other parties following a procedure similar to that of Article 2. Whether these two measures will be effective remains to be seen. For the moment, it appears that the United Nations' Economic Commission for Europe and the ISO Council Committee on Certification (CERTICO), in response to the GATT agreement, are working on international documents that would provide for the co-ordinated development of national certification systems. But, already, philosophical problems related to participation, open or otherwise, have arisen.[30]

The last fundamental obligation assumed by parties under the agreement, as concerns technical regulations and standards as such, relates to information. According to Article 10.1, "[e]ach Party shall ensure that an enquiry point exists which is able to answer all reasonable enquiries from interested parties in other Parties." Such inquiries may concern any technical regulations, any standards, any certification systems, adopted or proposed by central or local government bodies, by non-governmental bodies, or by regional standardizing bodies of which it is a member. Copies of pertinent documents must be supplied, in the language of the party, upon request by other parties, at the same price charged to nationals of the party concerned. After that, the last paragraph of Article 10 appears to be an understatement when it proclaims that "Parties recognize the desirability of developing centralized information systems." The truth is that it will probably take some years before parties to the agreement are capable of compliance with the requirements of Article 10.[31] Right now, it would be interesting to know how many local governments in the United States and Canada are in a position to provide an exhaustive list of all their technical regulations.

D. The "Developing Countries" Clause

All the GATT codes on non-tariff barriers contain provisions that purport to grant special and differential treatment to developing countries. This was inevitable, since the Tokyo Declaration on Multilateral Trade Negotiations explicitly proclaimed in 1973 that one of the two essential aims of those negotiations was "to secure additional benefits for the international trade of developing countries. . . ."[32] As a matter of fact, this special and differential treatment approach to the problems of developing countries is part of a wider movement that tends to question the adequacy of the existing international economic order for the solution of those problems, when it does not consider such order directly at their origin.[33] However, the new international economic order sought by the developing countries remains an ambiguous concept, and apart from some claims that appear incompatible with the principles of economic liberalism, such as, for instance, the demand concerning the indexation of prices, it centres mostly around special treatment clauses in international economic agreements that are no worse, nor more effective, in the long run than the safeguard clauses granted to developed countries themselves.[34] There is, indeed, something disheartening in this formal recognition of the problems of developing countries. The feeling that remains is that special and differential treatment clauses are essentially a gesture that had to be made in order to appease developing countries during the negotiations. This is not to say that the codes on non-tariff barriers are devoid of significance as far as developing countries are concerned; it is simply another way of saying that such codes were intended to deal primarily with developed countries' problems.

Two articles of the Agreement on Technical Barriers to Trade deal specifically with developing countries. The first one, Article 11, is entitled "Technical assistance to other Parties," and although written in general terms, it is really aimed at developing countries in need of help and advice on matters relating to technical regulations and standards. Its approach is of the traditional aid type and does not raise any problem except perhaps to the extent that it involves non-governmental bodies that may themselves require some form of financial help in order to provide technical assistance to other parties.[35]

The second article, Article 12, is the typical "developing countries" clause. It contains not less than ten paragraphs, some of which are fairly lengthy. Its substance, unfortunately, appears inversely proportional to its length. It is largely declarative, often repetitive, and in the last resort it does not add much to what was already contained in other articles of the agreement. A good example is Article 12.3, which speaks of the duty of parties to ensure that their technical regulations, standards, testing procedure, and so forth, "do not create unnecessary obstacles to exports from developing countries": it simply repeats what is already said in Article 2.1.

There is, nevertheless, one provision that does create a true regime of exception in favour of developing countries. This is Article 12.4, which states:

> Parties recognize that, although international standards may exist, in their particular technological and socio-economic conditions developing countries may adopt certain technical regulations or standards, including test methods, aimed at preserving indigenous technology and production methods and processes compatible with their development needs. Parties therefore recognize that developing countries should not be expected to use international standards as a basis for their technical regulation or standards, including test methods, which are not appropriate to their development, financial and trade needs.

The effect of this provision is to exempt developing countries from the obligation of Article 2.2 to use international standards except where such standards can be shown to be inappropriate; it is no more, legally, than a simple presumption in their favour. In another sense, however, it goes beyond that. There is an implicit recognition in this provision that international standards carry with them characteristics as to production methods and processes. If developing countries had been obliged to adopt such international standards, their capacity to produce with a less advanced, but sometimes better suited, technology might have been seriously endangered. An exception, therefore, had to be made in order to ensure that an impossible goal was not assigned to developing countries.[36]

E. The Dispute Settlement Procedure

The Agreement on Technical Barriers to Trade, in common with the other agreements on non-tariff barriers to trade, contains a fairly detailed procedure for the settlement of disputes. Indeed, one can see, in this updating of the GATT dispute settlement system, one of the most significant contributions of the Tokyo Round to the development of international economic law. How all this will evolve in practice again remains to be seen. But the mere fact that the Contracting Parties have come to regard dispute settlement procedures as something positive, a kind of common surveillance mechanism, augurs well for the future.[37]

The general pattern of Article 14, which deals with consultation and resolution of disputes, may be considered a priori as a detailed application of Articles XXII and XXIII of the General Agreement. Although similar in outlook, however, these two dispute settlement mechanisms do not stand at the same level: whereas Articles XXII and XXIII of the GATT concern rights and obligations under the General Agreement and are available to all Contracting Parties, Article 14 of the Standards Code concerns obligations that go beyond those of the General Agreement, and it is available only to those Contracting Parties that have accepted or acceded to the code.[38] As a result, there is an undertaking in Article 14.23 not to use the two procedures indiscriminately: if a dispute arises between parties relating to rights and obligations under the Standards Code, parties must complete the dispute settlement procedures under the code before availing themselves of any rights that they have under the GATT.

The procedure of Article 14 may be described summarily as follows. If, after consultations, a solution has not been found to a dispute, any interested party may request the intervention of the Committee on Technical Barriers to Trade, which is the surveillance body set up for this purpose by the agreement.[39] Within thirty days of receipt of such request, the Committee must meet in order to investigate the matter and suggest the most appropriate method for the solution of the dispute. At that stage, the Committee acts essentially as a mediator. Competent bodies and experts in matters under consideration may be consulted and invited to the meeting of the Committee.[40]

If after three months of the initial request no mutually satisfactory solution has been reached, then a fundamental choice arises. The parties to a dispute may consider, on the one hand, that such dispute relates essentially or partly to questions of a technical nature, and accordingly may request the Committee to establish a technical expert group, composed of persons of professional standing and experience serving in their individual capacities, preferably government officials, but not linked in any manner with the government of the parties involved in the dispute, with the mandate to make such findings as would assist the Committee in making recommendations or giving rulings on the matter.[41] The parties to a dispute may consider, on the other hand, that the issues raised relate essentially to commercial policy considerations and opt immediately for the establishment of a panel composed of persons "knowledgeable in the area of technical barriers to trade and experienced in the field of trade relations and economic development," serving here again in their individual capacities.[42] The task of the panel is to prepare a report of conciliation for submission to the Committee. Where a dispute involves at the same time questions of a technical nature and commercial policy considerations, both the fact-finding procedure and the conciliation procedure can be used. Technical expert groups are expected to deliver their findings within six months and panels within four months.

Once the investigation is complete and the Committee is in possession of all the necessary information, it must give the matter prompt consideration. This means that within thirty days of receipt of a panel report, the Committee shall normally be in a position to provide the parties with a statement concerning the facts of the matter, recommendations to one or more parties involved in the dispute, and any other ruling that it may deem necessary.[43] If a party is unable to act upon the recommendations of the Committee, reasons have to be furnished and further action is then envisaged.[44] According to Article 14.21:

> If the Committee considers that the circumstances are serious enough to justify such action, it may authorize one or more Parties to this Agreement to suspend, in respect of any other Party, the application of such obligations under this Agreement as it determines to be appropriate in the circumstances.

Retaliation is thus considered as a method of restoring mutual economic advantage and balance of rights and obligations between the parties, and is the ultimate sanction of the agreement.

This detailed procedure for the settlement of disputes is characterized by its conciliatory overtone, by the importance given to expert groups and panels, and by an obvious desire to ensure a speedy solution to disputes. All along, it is clear that the initiative for the solution of a dispute rests primarily with the parties to such dispute: the responsibility is at the bottom, not at the top. This is so much the case that one can already foresee certain difficulties in practice. Thus, it is very well to leave the parties to a dispute to decide whether to go before a technical expert group or a panel. But what happens if the complainant opts for one procedure and the defendant for another one, or if there is no agreement about the exact composition of the expert group or of the panel? Such difficulties can certainly be overcome. Yet it is clear that the occasions to test the good faith of the parties will not be missing.

The new emphasis put on fact finding and conciliation as evidenced in the institutionalization of expert groups and panels curiously leaves some doubts as to the exact intention of the Contracting Parties in this respect. The difficulty is that although the respective role of such bodies is fairly well delineated on paper, their composition by contrast appears too identical to guarantee distinct outputs. What is noticeable in particular is the preference given to government officials in both mechanisms: one would have thought that this preference, justifiable in the case of conciliation, was simply not of the essence in fact finding. However that may be, this choice now raises a new problem. Since certain states such as the United States and Canada are characterized by the predominance of non-governmental bodies in their standardizing systems, a good many of their experts inevitably will be excluded from the dispute settlement procedure set up by the agreement. In the long run, this may weaken the confidence of these non-governmental bodies in the GATT system for the settlement of disputes, a development that is certainly not desired by their respective governments.

In the last resort, the effectiveness of the dispute settlement procedure will obviously depend on the willingness of each country to use it. As far as the United States is concerned, the Trade Agreements Act of 1979,[45] through an amendment to the Trade Act of 1974,[46] has introduced a number of provisions that will compel the U.S. administration to have more frequent recourse to the international dispute settlement system provided for in the various trade agreements. The new Article 303 of the Trade Act of 1974 declares in particular:

> On the date an affirmative determination is made under section 320(b) with respect to a petition, the Special Representative, on behalf of the United States, shall request consultations with the foreign country or instrumentality concerned regarding the issues raised in the petition. If the case involves a trade agreement and a mutually acceptable resolution is not reached during the consultation period, if any, specified in the trade agreement, the Special Representative shall promptly request proceedings on the matter under the formal dispute settlement procedures provided under such agreement.

In the case of Canada, there is no such legislative recognition of an intent to use international dispute settlement procedures, simply because it was not felt necessary. However, the considerable interest manifested in this respect by Canada during the negotiations can probably be seen as an equivalent guarantee of its good faith.

3. The Future of the Code

The Agreement on Technical Barriers to Trade can certainly be considered as one of the most serious efforts made so far to deal with what has been termed "involuntary obstacles to international trade." However, it is anything but a complete and definitive solution to the problems raised by technical regulations and standards in international trade. Among the problems that remain, one can distinguish those that relate to questions partly dealt with in the agreement, and those that relate to questions left outside the agreement. In the first category, mention must be made of the problem of reciprocity, the problem of confidentiality, and the transfer-of-technology problem; the second category includes such questions as the limits of private standardization and the time and adaptation factors in international standardization. In the following pages, I shall briefly discuss the nature of these problems and how they may affect the implementation of the agreement.

A. The Problem of Reciprocity

During the negotiations on the GATT standards code, as already mentioned, lengthy discussions took place concerning the intricate problem of reciprocity raised by local government and non-governmental standardizing bodies. The solution eventually arrived at involved the use of a double level of obligation, one for central government bodies, and one for local government and non-governmental bodies But this complex mechanism deals with only one aspect of the problem of reciprocity.

In order to eliminate unnecessary obstacles to international trade, the parties have also agreed to use, whenever possible, international standards, and where this is found inappropriate, to use a prior notification procedure allowing for comments from interested parties. In theory, the second method is subordinate to the first one and should only be used exceptionally. In practice, however, there is a danger that these two methods may be considered as alternatives, with the result that many states may be tempted to stick to their own standards, after the necessary consultations with other parties. If this were to happen, states using international standards would find themselves opening their markets to imports, without achieving equivalent gains in the export markets of those states retaining their own standards.

This is not a purely hypothetical problem. As recently as January 1980, the director general of the British Standards Institution was complaining that many industrialized countries still preferred their own national standards to any available ISO or IEC standards. He made the following comment:

> During 1980, we intend to have a searching enquiry into the cost/benefit of our international standards work, particularly as it affects the terms of trade between the United Kingdom and its trading partners. If it emerges that our industrial competitors overseas are lagging as seriously behind in implementing international standards as now appears, we shall carry the debate into the major international standards fora. We now give notice that we have made a real effort in the United Kingdom to implement international standards without deviation, but we cannot continue this process indefinitely unless the other major industrialized countries do the same.[47]

Such a comment clearly shows the importance of the problem raised and its significance for the future of the code.

B. The Problem of Confidentiality

Among the many problems dealt with in the Agreement on Technical Barriers to Trade, that of confidentiality of information may not appear at first sight as very significant. Yet the kind of treatment that it receives in the code suggests that the Contracting Parties were rather ambivalent as to its real importance.

In Article 5.1.6, which concerns test methods and administrative procedures, it is simply stated that "the confidentiality of information about imported products arising from or supplied in connexion with such tests shall be respected in the same way as for domestic products." This "national treatment" clause concerning the confidentiality of information can hardly be considered as a guarantee in the absence of a clear indication of how parties behave internally in this respect. Unfortunately, there is not much information on the subject, and the little we have learnt concerning the specific case of Canada would definitely prevent us from proposing this country as a model.[48]

The total absence of any mechanism of control in this respect appears to create a serious problem. Testing methods, as seen previously, raise difficulties in international trade because they can easily be used to discriminate against foreign products. But at least where discrimination can be shown to exist, the parties affected have a remedy under Article 5. In the case of confidentiality, the problem is different. Confidence must exist at the outset when a party submits what it considers to be an important technical innovation to foreign testing. The existence of a subsequent remedy will never entirely compensate for the divulgence of confidential information. The significance of the problem is enhanced by the fact that in the field of health and safety regulations, there are suggestions now that the results of experimental testing submitted by the proponents of a product should be made available to the public.[49] For the future, there are indications that the confidentiality of information, in regard to standards and technical regulations, may become more and more of a problem.

Curiously, there are two other provisions in Annexes 2 and 3 of the agreement that deal with confidentiality of information and show that the Contracting Parties were quite aware of the problem. They concern technical expert groups and panels, and they are essentially identical in their content. They read as follows:

> Confidential information provided to the technical expert group [panel] shall not be revealed without formal authorization from the government or person providing the information. Where such information is requested from the technical expert group [panel] but release of such information by the technical expert group [panel] is not authorized, a non-confidential summary of the information will be provided by the government or person supplying the information.

The least one can say is that the problem of confidentiality is considered here much more seriously than in Article 5.1.6. The reason perhaps is that the experience gained with anti-dumping tribunals in various countries has shown the importance of a balanced approach to the problem of confidentiality.[50] If technical expert groups and panels are to work effectively, they need all the necessary information, including information that may be considered confidential; such information cannot be obtained without at least some guarantee as to limited circulation. By the same token, however, confidentiality must not become an excuse for limiting the ordinary application of the rules of natural justice: all parties involved in a conflict must have a fair chance of defending themselves, including a knowledge of all arguments used against them. In that sense, the provisions in Annexes 2 and 3 on confidentiality are quite satisfactory. But they emphasize at the same time the inadequacy of Article 5.1.6. in so far as national test methods and administrative procedures are concerned.

C. The Technological Impact of International Standards

That the Contracting Parties were quite aware of the problem raised by the technological impact of international standards during the negotiations cannot be doubted. There are at least four clear textual indications of this. In the preamble, first of all, there is an explicit recognition of the contribution that international standardization can make to the transfer of technology from developed to developing countries. Then in Article 2.4, there is an injuction that wherever appropriate, parties shall specify technical regulations and standards in terms of performance rather than design or descriptive characteristics. The next article that manifests a clear understanding of the problem is Article 12.4: by virtue of that provision, developing countries are allowed not to adopt international standards where the preservation of their indigenous technology is involved. And finally, there is Article 14.25, which specifies that the dispute settlement procedure can be invoked ". . . where a Party considers that obligations under this Agreement are being circumvented by the drafting of requirements in terms of processes and production methods rather than in terms of characteristics of products." However, these provisions deal with only two aspects of the problem: the impact of international standards as between developed countries and the impact of international standards on developing countries. Left aside is another important problem, that of the impact of international standards upon the trade rivalry between developed countries for the market of developing countries.

The problem has much in common with that of export credit financing.[51] In both instances, developed countries are competing among themselves for the vast markets of developing countries. In both instances also, developing countries benefit to some extent from this competition. But there are important differences too. In the case of export credit financing, each state takes its own decision and remains solely responsible for its implementation. In the case of international standards, the process is much more diffuse. Each individual state may push its own standard as a basis for an international standard, but the international standard ultimately adopted will always be the result of a consensus among all national organizations involved in its elaboration. Nevertheless, where one state cannot easily succeed, many states forming an homogeneous block may exercise such an influence that an equivalent result is attained. Since developing countries, in the absence of national norms, are prone to adopt international standards, the potential gain is obvious and the incentives for block tactics are strong. Regional standardizing organizations, from this point of view, take on a particular importance and one could easily look at CEN (European Committee for Standards Coordination) and CENEL (European Committee for Electrotechnical Coordination) on the one hand, and the Pan American Standards Commission on the other hand, as competing zones of influence. The following question, recently raised before a committee of ASTM (American Society for Testing and Materials), the most important standards writing organization of the United States, appears symptomatic in this respect:

> Would it be in the United States trading interest to explore further mechanisms by which the United States could make LDCs aware of the usefulness of certain United States standards in areas likely to influence the direction of LDCs trade? For example, should the United States renew its relationship with the Pan American Standards Commission? Or should we confine our activities to multilateral organizations, such as ISO of IEC?[52]

Nearly all developed countries, including Canada, are raising similar questions.[53] This attitude is so widespread that one wonders whether the commitment of developed countries to international standards is stronger than their desire to expand their export markets. As long as this ambivalent attitude prevails, the future of the GATT code on standards will remain uncertain.

D. The Limits of Private Standardization

The Agreement on Technical Barriers to Trade realistically accepts that private standardizing bodies exist and integrates them into its working through a "best endeavours" obligation imposed on the parties to which they belong. No questions are raised as to their impact and no position is taken as to the limits of their contribution to the realization of the objectives of the agreement. And yet, there are clear indications that the participation of private bodies in the process of standardization is considered with some reserve in many quarters.

Thus, in a study prepared in May 1973 by the Economic and Social Council of the European Communities, in preparation for the coming multilateral trade negotiations, the view was expressed that standards adopted in the United States by producer-controlled organizations should be accepted with caution in international trade.[54] Even in the United States, a strong movement had developed in recent years that urges a more restrictive approach to private standardization.[55] For some time now, the Federal Trade Commission has been working on the subject, and a trade regulation rule on standards and certification has been proposed that purports to regulate the organizational structure and procedures for decision making on the part of private standardizing organizations.[56]

The basic idea behind such criticisms is that ". . . standards almost amount to a specific exemption to the antitrust laws, and therefore would be better handled governmentally rather than through private voluntary action."[57] This is not to say that non-governmental organizations have not played a useful role in the past or that they should not be allowed to play a certain role in the future. The problem, from the point of view of international trade, is that standards have such great external ramifications that they simply cannot be left in the hands of private vested interests without at least some guarantee as to their impartiality. It is very well to ask non-governmental standardizing bodies to follow the principles of the agreement, but where they suffer from a structural defect that prevents them from doing so, the exhortation is to no avail, unless of course some norm or standard prescribes how such bodies are to operate in their standardizing work. The least that the agreement should have done in this respect would have been to request parties to standardize the operation of their non-governmental standardizing bodies.[58]

Presently, among national standardizing organizations, there are some that are structured in such a way that private vested interests simply cannot prevail over the general interest. This is the case for instance in France and the United Kingdom, where the organizations responsible for standardization, AFNOR and BSI, are controlled by representatives of various sectors of interests, including government. In other countries, such as Canada and the United States, standardization is largely left in the hands of non-governmental bodies; if there exists a national organization equally representative of all sectors of interest, including government, its essential role is to co-ordinate the activities of private standardizing bodies and not to develop standards itself.[59] These national organizations generally attempt to compel private organizations to submit their standards for adoption as national standards; but their success, particularly in Canada, has been less than convincing because of their lack of authority.[60] In the case of the United States, however, the rigid rule adopted by the most important private standardizing body, ASTM, which requires that no standard be adopted by a committee unless this committee is composed in such a way that producers do not outnumber non-producers (including consumers, specialists, government representatives, etc.) has done much to re-establish a certain balance.[61] Such a rule illustrates the kind of minimum requirement that could have been inserted in the agreement with regard to private standardizing bodies.

E. The Time and Adaptation Factors in International Standardization

These two problems are well known among specialists in standardization, both at the national and international levels. In essence, the problem of time concerns the delay, expressed in terms of years, necessary for the adoption of a standard. While this may take between two and three years at the national level, it seems that standards writing, at the international level, can easily take between five and seven years. One of the consequences of the Agreement on Technical Barriers to Trade may be that for those states which are parties to it, the delay required for the adoption of a national standard will come closer to the delay required for the adoption of an international standard. This is easy to understand since parties to the agreement, if they do not adopt an international standard, must follow a procedure of advance notice that has much in common with that used for the adoption of international standards. The problem may be overcome, but serious effort will have to be made in order to rationalize the procedure for elaboration of standards.

At the international level, serious efforts have already been made in recent years to shorten the period of time required for the adoption of international standards. But the gains realized may easily be lost with the more active participation of parties in the work of international standardizing organizations; such active participation, as we know, is now a duty under the agreement. Moreover, if the adoption of national standards is similarly delayed because of the procedures imposed by the agreement, then a serious backlog in the standardizing work, both at the national and international level, may eventually follow. As a result, a fundamental re-evaluation of the efficacy of the agreement, in an unfavourable context, might become necessary, which is something that absolutely must be avoided. For the moment, what appears essential is a close monitoring of the time factor in the working of the agreement; later on perhaps, if adjustments are necessary, at least detailed information on this problem will be available.

The other factor that has to be taken into consideration in the implementation of the Agreement on Technical Barriers to Trade concerns the capacity of the existing international standardizing system to adapt to technological changes. This is already a problem at the national level. The country that has the best record in this respect is the United States where ASTM has an ongoing review system that permits an annual re-edition of all its existing standards.[62] In most states, however, such an operation occurs at best every three to five years. With international standards, the problem is even more intricate because of the greater number of participants involved. Thus, if international standardization is to become an essential mechanism in the elimination of technical barriers to trade, something will have to be done on this subject.

Conclusion

In conclusion, two types of judgements can be made concerning the Agreement on Technical Barriers to Trade, depending upon the perspective one adopts in this regard. Some will consider that it goes too far, that it complicates unduly the process of standardization without any assurance of real gains in terms of international trade. Others will consider that it is not enough, that it remains a weak response to a new and treacherous form of international economic warfare. In my view, the Agreement on Technical Barriers to Trade is more a second-best solution to a very delicate problem that had to be faced at this stage in the evolution of the international economy.

The truth is that standards and technical regulations have become in recent years a serious problem for international trade. As recently as February 1980, a French economic commentator was complaining bitterly about the dirty tricks of such states as the United States, Japan, and Germany in the field of standards and technical regulations, and he was asking for a more realistic attitude on the part of the French government in that respect.[63] In such a context, any effort to promote the elimination of voluntary as well as involuntary obstacles to international trade resulting from standards and technical regulations deserves to be taken seriously. At the same time, it is obvious that the agreement suffers from many failings. Among other things, its fundamental proposition that international standards should be used wherever possible as a basis for national standards and technical regulations simply assumes that such international standards are not themselves subject to criticism. The agreement also leaves much room for manoeuvre to the parties. As a result, it remains fairly easy for a state that wishes to circumvent it to do so, particularly with regard to local and non-governmental standardizing bodies. There is, admittedly, a fairly detailed procedure for dispute settlement provided for in the agreement: but it is not clear yet to what extent it will be used, since it may involve the intervention of three, if not four, different bodies. As can be seen, a pessimistic reading of the agreement is fairly easy.

But whether it is too much or too little is no longer the question. The agreement simply corresponds to what was acceptable at the moment when it was negotiated. Only experience will tell us whether fundamental changes are necessary.

Notes

[1] This definition is taken from Annex 1 of the GATT Agreement on Technical Barriers to Trade, MTN/NTM/W/192/Rev. 5, 29 March 1979, *International Legal Materials* 18 (1979), p. 11068. There are, however, other more elaborate definitions that have been put forward by various standardizing organizations.

[2] This distinction is made in the GATT Code on Standards: see Annex 1 of the agreement.

[3] GATT, document MTN/3b/3, 304 (1974).

[4] *Ibid.*, notification 305.

[5] *Ibid.*, notification 322.

[6] Interesting comments on this subject may be found in an ISO document entitled "International Standardization and Harmonization of Standards," ISO/STACO WG2 Principles/99 (Rev.), February 1980.

[7] See "An Interview with ASTM President William A. McAdams," *ASTM Standardizing News* (July 1977), p. 13.

[8] *Ibid.*, p. 12; for a similar point of view, see also Silve Kallmann, "International Standardization: A Different Perspective," *ASTM Standardizing News* (September 1979), pp. 23–24.

[9] Other provisions concerned more or less directly with the problem of standards and technical regulations are Articles I, VIII, X, XI, XVII, XVIII, XXII, XXIII, and XXIV (5).

[10] For a similar judgement, see Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970), p. 195.

[11] GATT, Doc. L/2967, at 29 (1968).

[12] GATT, Doc. COM.IND/W/108.

[13] GATT, Doc. MTN/NTM/W/192/Rev. 3.

[14] GATT, Doc. MTN/NTM/W/192/Rev. 5.

[15] See in general on this subject, Ivan Bernier, *International Legal Aspects of Federalism* (London: Longmans, 1973), pp. 152–71.

[16] Those positions are fairly well reflected in a document circulated by the Information Bureau of the European Communities in Geneva in May 1978, entitled "Towards a Code on Technical Obstacles to Trade," (Doc. CVM/NVP 31 May 1978).

[17] John H. Jackson "The General Agreement on Tariff and Trade in United States Domestic Law," *Michigan Law Review* 66 (1967): 307. His view is that Article XXIV (12) must be interpreted so as to apply only to the situation where the central government does not have the constitutional power to control the subsidiary government. Faced with the divergent interpretation to be found in the interpretative note annexed to Article III, he argues that this note has no bearing on the interpretation of Article XXIV (12). See also, by the same author, *World Trade and the Law of GATT* (New York: Bobbs-Merrill, 1969), p. 114.

[18] The classical comparative study on the subject is that of Alexander Smith, *The Commerce Power in Canada and the United States* (Toronto: Butterworths, 1963).

[19] Bernier, *op. cit.*, pp. 153–60.

[20] U.S., Congress, Senate (96th Congress, 1st Session), Report no. 96–249, 17 July 1979: reproduced partly in *International Legal Materials* 18 (1979), p. 1359.

[21] This document, which does not appear to have received any official sanction, is entitled "Propositions for the Implementation in Canada of the GATT Agreement on Technical Barriers to Trade."

[22] *Re Fisheries Act, 1914*, [1930] 1 D.L.R. 194 at 197; *The Queen* v. *Klassen*, (1959) 20 D.L.R. (2d) 406 at 412.

[23] This idea that standards constitute a common language for all those interested in a product is not new. *Enjeux*, which is the new French publication in the field of standards, takes up the idea in its first issue dated 1 March 1980, p. 40.

[24] "Interview with ASTM President. . . ." The interest shown by many developed countries in obtaining the secretariat of technical committees, which they consider important for them, is a good indication of this.

[25] An interesting comment in this respect is that of Bernard Vaucelle, Director General of AFNOR, the French standardizing organization, who states in the first issue of *Enjeux* that international standards will have to offer a choice between various levels of quality and security in order to adopt to the needs of various countries (p. 22).

[26] Some indications as to the cost involved in the United States only are provided in the "Final Report from the American National Standards Institute Under Department of Commerce Contract No. 6-35789 on Implementation of Provisions of the Proposed GATT Standards Code," pp. 13–15.

[27] *Ibid.*, p. 15.

[28] There has already been a series of international meetings on laboratory accreditation under the designation of International Laboratory Accreditation Conferences: see Standards Council of Canada, *National Standards Development*, Doc. CAN-P-5A, first draft, January 1980, p. 25.

[29] *Ibid.*, pp. 27–28.

[30] *Ibid.*, pp. 24–25.

[31] This conclusion comes out from the two implementation documents mentioned previously, that of the United States (note 26), and that of Canada (note 21).

[32] GATT Press Release GATT/1134 of 14 September 1973. The text of the Declaration can be found in *International Legal Materials* 18 (1973), p. 1533.

[33] See, for instance, Charles. N. Brower and John B. Tepe Jr., "The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law?" *The International Lawyer* 9 (April 1975): 295–318. For a general analysis of the impact of the Tokyo Round on developing countries, see Bela Balassa, "The Tokyo Round and the Developing Countries," *Journal of World Trade Law* 14 (1980): 93–118.

[34] On the ambiguity of the new international economic order, see I. Bernier, "Souveraineté et interdépendance dans le nouvel ordre économique international," in *The International Law and Policy of Human Welfare*, edited by R. Macdonald, D. Johnston, and G. Morris (Leyden: Sijthoff and Noordhoff, 1978), p. 425.

[35] See note 26, p. 29.

[36] This is a well-known problem in the literature on the transfer of technology to developing countries. See in particular the work of UNCTAD with regard to the establishment of an international code of conduct on transfer of technology. See also A.F. Ewing, "Transfer and Development of Technology: The Problems of Developing Countries in Perspective," *Journal of World Trade Law* 11 (1977): 1–14.

[37] Not long ago, the situation was so bad in this respect that the simple threat to use the procedure of Article XXIII of the GATT was almost considered as an inimical gesture:

see John H. Jackson, "Governmental Disputes in International Trade Relations: A Proposal in the Context of GATT," *Journal of World Trade Law* 13 (1979), p. 5.

[38] On the danger of such multiple overlapping procedures, see Jackson, "Governmental Disputes in International Trade Relations. . .," p. 11.

[39] The composition of this Committee and its functioning are set forth in Article 13 of the agreement.

[40] Agreement, Article 14, paragraphs 3 to 8.

[41] *Ibid*., Article 14, paragraphs 9 to 13.

[42] *Ibid*., Article 14, paragraphs 14 to 18.

[43] *Ibid*., Article 14, paragraph 19.

[44] *Ibid*., Article 14, paragraph 20.

[45] U.S. Public Law 96–39 of 26 July 1979, reproduced in *International Legal Materials* 18 (1979): 1256–1307.

[46] Section 901 of the Trade Agreements Act of 1979, modifying chapter I of title III of the Trade Act of 1974 (19 U.S.C. 2411).

[47] *BSI News* (January 1980), p. 3.

[48] The following remark made by the Standards Council of Canada is interesting in this respect: " . . . it needs to be remembered that international standardization has been correctly described as a transfer of technology. It is unquestionably a source of technological intelligence, whether gleaned from documents or social and personal interaction at meetings." See *National Standards Development*, p. 15.

[49] See, for instance, Thomas O. McGarity and Sidney A. Shapiro, "The Trade Secret Status of Health and Safety Testing Information: Reforming Agency Disclosure Policies," *Harvard Law Review* 93 (1980): 837–88. See also note 20, p. 1360.

[50] See, for instance, Philip Slayton, "The Canadian Anti-dumping System," *Canadian Business Law Journal* 2 (1977–78), pp. 451–53; also Marguerite E. Ritchie, "Experimenting With Canadian Business: Anti-dumping in Canada," *Canadian Business Law Journal* 3 (1978–79), pp. 393–95. See also the recent study by Eric I. Garfinkel, "Disclosure of Confidential Documents Under the Trade Agreements Act of 1979: A Corporate Nightmare," *Law and Policy in International Business* 13 (1981): 465–93.

[51] See in particular on the subject the fundamental study made by the Department of Economic and Social Affairs of the United Nations entitled *Export Credit and Development Financing* (1967), Doc. E/4274 ST/ECA 95 and E/4274/Add. 1 ST/ECA/96.

[52] ASTM, Committee on International Standardization, "The Role of the U.S. Federal Government in International Standardization Activities," *ASTM Standardizing News* (April 1980), pp. 16–18,52.

[53] For Canada, see *National Standards Development*, p. 15.

[54] Conseil économique et social, *Rapport sur le problème des échanges internationaux. Les prochaines négociations entre la C.E.E. et les autres membres du GATT*, 17 May 1973, p. 406.

[55] See, for instance, W.J. Curran, "Industrial Standards, Antitrust, and the Logic of Public Action: An Historic Search for a Rational Public Policy," *Duquesne Law Review* 17 (1978–79): 717–54.

[56] Walter V. Cropper, "An Interim Report on the Status of the FTC Proposed Trade Regulation Rule on Standards and Certification," *ASTM Standardizing News* (October 1979), pp. 36–37, 67.

[57] Curran, *op. cit*., p. 748.

[58] In its first section, admittedly, the agreement refers back to the general terms used by international standardizing organizations, which includes a fairly strict definition of what is a standard writing body. But this does not solve the problem of existing standardizing bodies that do not conform to such definitions.

[59] Those national organizations are the American National Standards Institute (ANSI) and the Standards Council of Canada (SCC).

[60] See note 26, p. 23, and note 28, pp. 1–2.

[61] See Robert F. Legget, *Standards in Canada* (Ottawa: Information Canada, 1971), p. 126.

[62] *Ibid.*, p. 127.

[63] Michel Richard "Les coups fourrés du commerce international," *Le Point*, No. 385 (4 February 1980), p. 78.

Enforcing the MTN Codes: A Proposal for a Canada–United States Trade Commission

10

by
Hon. Donald S. Macdonald, P.C.

1. Introduction

Previous essays have focused on the substance of the various changes brought about by the Multilateral Trade Negotiations (MTN). The purpose of this essay is to comment on procedure — the process by which the substance of those changes is to be carried out — and the institutions through which those procedures may be exercised.

On some of the subjects covered by the MTN, procedures and institutions are already well established. Both the United States and Canada provide judicial and quasi-judicial remedies for airing disputes about tariff determinations, or about anti-dumping or countervailing duties. The existing procedures for dealing with those disputes have been the subject of extensive comment. It is my intention to consider institutional arrangements for carrying out two new areas of international law making under the GATT: the Technical Standards Code and the Government Procurement Code.

In discussing those questions, we have the benefit of the U.S. Trade Agreements Act of 1979 and other provisions of U.S. law that relate to those subjects. In Canada we do not as yet have a clear indication as to how the government will proceed to put in place institutions to assure the carrying out of the terms of the two codes in Canada. That gives us an opportunity — the opportunity of writing on a *tabula rasa* our recommendations for procedure. So my order will be (1) to take each of the subjects in turn: government procurement and then technical barriers; (2) to examine what the U.S. Congress has done in the Trade Agreements Act; (3) to survey the actions that the Cabinet and Parliament are likely to take in Canada; and (4) to conclude with some suggestions for a bilateral institution designed to deal with disputes between the two countries.

Before embarking on a more detailed discussion, I would respond to the more general question: why worry about the procedure and the institutions? The reply is that unless mechanisms are put in place whereby firms on both sides of the border can have a prompt, fair, effective, and relatively low-cost means of dealing with disputes about non-tariff barriers, the new codes will fail to achieve the objectives for which they were drafted. My purpose is to see to what extent effective procedures have been established for reinforcing the rights achieved by these agreements. Unless the rights can be effectively supported, they will remain little more than theoretical. If, on the contrary, an effective procedure for redress comes into common use, then the goal of achieving fairer trade practices through legal standards will have been achieved.

From a Canadian standpoint, if we are to achieve the aim of increasing our exports of finished end-products, then we are going to have to win a share of the government market for goods (demand of all governments in the United States for goods and services is estimated at $90 billion).[1] If Canadian products are to be competitive in larger markets such as the United States or the European Community, which have well-established practices for setting their own standards, then we are going to want to be assured that Canadian competition will not be thwarted by hidden restrictionism in the standard-setting process. Very true, you may say, but what has *Canadian* procedure got to do about that? The answer is that frequently in trade relations, reciprocity is everything, and Canada will succeed in its search for fairness in *foreign* administration to the degree that we can show we accord the treatment we seek. Despite the much avowed principle of international law about the equality of states, countries like Canada with smaller domestic markets are like the No. 2 car rental agency: they have to try harder.

2. Government Procurement

A. United States

Title III — the part of the Trade Agreements Act of 1979 devoted to government procurement — is one of the shortest parts of the statute. The main provision is section 301(a), which stipulates the following:

> PRESIDENTIAL WAIVER OF DISCRIMINATORY PURCHASING REQUIREMENTS. — The President may waive, in whole or in part, with respect to eligible products of any foreign country or instrumentality designated under subsection (b), and suppliers of such products, the application of any law, regulation, procedure, or practice regarding Government procurement that would, if applied to such products and suppliers, result in treatment less favorable than that accorded —
> (1) to United States products and suppliers of such products; or
> (2) to eligible products of another foreign country or instrumentality which is a party to the Agreement and suppliers of such products.

Subsection (b) makes it clear that a waiver is to be made only in favour of a country that is party to the agreement, or will assume obligations that accord beneficial governmental procurement opportunities to U.S. suppliers, or is a least developed country.

The reason that the title is otherwise so brief is that U.S. federal law already requires the federal government to achieve a high degree of openness and competition to bidders by providing extensively for competitive-bidding procedures. Title 41 of the U.S.C.A./5 and following, is intended to provide the assurance to bidders of well-advertised calls for tenders, and fair and open choice among contenders. The existing U.S. law also provides expressly a discriminatory "Buy America" standard in procurement. The elaborate provisions of title 41 are backed up by review and appeal provisions that entitle bidders to have the procedure in a bid scrutinized by the General Accounting Office and ultimately, on questions of law, by the U.S. Court of Claims.[2]

The Trade Agreements Act of 1979 has the effect, therefore, of putting a foreign supplier from a country approved by the President in the same position as a U.S. citizen in terms of being able to bid for U.S. procurement contracts by the entities and for the products set out in Annex I to the Agreement on Government Procurement.

B. Canada

In Canada, the government procurement process is, in general, governed by the Government Contracts Regulations[3] under the Financial Administration Act.[4] While the Regulations are far less elaborate than those in the United States, the requirement of public tender in appropriate cases and after due public advertisement or notice is accepted as a principle. What is far less elaborate is the procedure available to an aggrieved party in the event of a dispute. The kind of scrutiny provided in the United States by the General Accounting Office is not available in Canada, although recourse to the courts is ultimately available.

The difference between the two systems is typical of the difference in governmental styles and of legal structure, with the United States according an extensive right to litigation while Canada has chosen to follow a purely administrative route with the last word usually resting with government. Where a dispute develops in an existing contract between the government of Canada and a supplier, then negotiation between the supplier and, if necessary, a more senior officer in the department is a preferred course of acion. If negotiation is not successful, provided both parties agree, the assistance of a third party to mediate may be invoked. But if adjudication becomes necessary, recourse may be had to the courts.

The foregoing procedures apply, however, only in favour of a party whose bid has matured into a contract with the government. Unsuccessful bidders in a competition are not recognized as having any rights under the Canadian procedure, although some ingenuity has been used by counsel by way of actions for unjust enrichment, or in tort to overcome this limitation.[5]

In my view, the Canadian regulations with respect to the supply of goods should be drafted more explicitly in the terms of the Procurement Code, and a quasi-judicial procedure should be established, independent either of Treasury Board, the Department of Supply and Services, or the contracting department, to adjudicate complaints brought by bidders, domestic or foreign, as to the fairness of the bidding process. Such a procedure would provide quasi-judicial review of administrative action comparable to that carried out by the Tax Appeal Board on income tax decisions. The objects in setting up such a procedure should be the ones of assuring promptness of review by officials outside of the actual procurement process, and at a minimal cost to the potential supplier so that expense is not a discouragement to legal recourse. Appeal to the Federal Court on questions of law should be available for unsuccessful bidders as well as for those who have a contract with the Crown.

One concern expressed by those with experience of the U.S. review procedures is that the availability of recourse to litigation has submitted the whole process to an unreasonable number of appeals. A quick perusal of the U.S.C.A. indicates more reported cases involving appeals by unsuccessful bidders under the procurement sections than one will find under the entire Customs Act in Canada. A risk, I agree, but may not cultural differences between the two countries assure less resort to obstructive litigation in Canada? By comparison, the right to object to individual income tax assessments by a simplified procedure through the Tax Appeal Board has not overwhelmed that body.

3. Technical Barriers

In other parts of the MTN, the trade practices legislated against, say export subsidies or dumping, are relatively apparent even though proving them in a particular case may involve some difficulty. Standards legislation does not permit as clear-cut a distinction between good and evil. A domestic law of undoubtedly laudable intention — to protect health or safety, or to ensure consumer protection — may also have the effect of excluding imported products. A process for adjudicating between the two sets of purposes is essential in carrying out the Technical Standards Code.

A. United States

Title IV of the Trade Agreements Act of 1979 attempts to come to terms with these conflicts. Section 401 under title IV provides in part as follows:

> No standards-related activity of any private person, Federal agency, or State agency shall be deemed to constitute an unnecessary obstacle to the foreign commerce of the United States if the demonstrable purpose of the standards-related activity is to achieve a legitimate domestic objective including, but not limited to, the protection of legitimate health or safety, essential security, environmental, or consumer interests and if such activity does not operate to exclude imported products which fully meet the objectives of such activity.

Section 402 enjoins federal agencies engaged in standards-related activities to avoid creating unnecessary obstacles to foreign trade, and to be guided by international standards whenever developing national standards.

The administrative instrument by which the obligations of the code are to be applied to government activity is the Office of the Special Representative, or Special Representative for Trade Negotiations, which was established under the Trade Act of 1974.[6] The special representative was, of course, the leading American official in the negotiations, and the Trade Agreements Act continued the function in being, both for asserting the rights of U.S. citizens against foreign governments based upon alleged breaches of the non-tariff barrier codes, and to ensure that the American administration carries out its MTN undertakings.

The special representative is the American official to whom a party to the Agreement on Technical Barriers (i.e., a government, not a private party) or the government of a state that extends reciprocal benefits comparable to those under the agreement, may state a grievance alleging American violation of the obligations of the agreement. The special representative's duty after reviewing the complaint is to consult with the appropriate federal agencies, including that agency against which the violation is alleged. The special representative does not have the power to require an agency to change a standard or its application. His power is limited to that of consultation.[7] Unlike other facets of American trade law, such as the provisions related to government procurement, no recourse to the judicial process is available.

B. Canada

At the moment, there is no procedure under Canadian law whereby a complainant, domestic or foreign, may seek to resolve a conflict concerning the application of a Canadian standard that may have the effect of a technical barrier impeding international trade. While there is federal legislation that provides a framework for the standards-setting process,[8] there is no legal right to challenge standards. There is extensive federal legislation regulating environmental, health, and consumer matters. It accords only limited legal rights of challenge against the regulation-making process.[9]

4. Conclusions on Domestic Procedures

The foregoing brief review indicates a curious inconsistency on the part of the governments of both the United States and Canada with respect to the resolution of disputes arising from the new non-tariff barrier codes. In some cases the domestic law affords full legal rights to a complaining party, and in others the legislation is at pains to indicate that no rights are created. The state of the law in the two countries may be summed up as follows:

With respect to the government procurement provisions:

1. In the United States, through the General Accounting Office, there is an administrative review procedure carried out by a government entity independent of the procuring authority.
2. In addition to the right under (1), there is resort to the United States Federal Court system on the ground that the administrative decision was procured by fraud, or was capricious or arbitrary.
3. In Canada, both consultation and mediation are available in resolving disputes between the Crown and the owner of an accepted tender, and thereafter resort is available to the courts. There is no recourse for an unsuccessful bidder alleging inadequate information or partiality in a contract award.

On technical barriers:

1. In the United States, the special trade representative is under an obligation to consult with a foreign government (but not with a domestic or foreign private person who may be adversely affected by a technical standard).
2. The special trade representative may, if he so decides, refer the matter to the appropriate federal agency, which agency reserves its own right of decision with respect to application of the standard notwithstanding the reference.
3. Rather than enhancing the right of legal action on the basis of a technical barrier, title IV is restrictive of any additional legal rights. Section 421 states:

> Except as provided under this chapter, the provisions of this subtitle do not create any right of action under the laws of the United States with respect to allegations that any standards-related activity engaged in within the United States violates the obligations of the United States under the Agreement.

4. The foregoing limitation is reinforced by section 3(a) of the Trade Agreements Act, which provides:

> No provision of any trade agreement approved by the Congress under section 2(a), nor the application of any such provision to any person or circumstance, which is in conflict with any statute of the United States shall be given effect under the laws of the United States.

In effect, the MTN codes do not automatically become the law of the United States, but only to the extent that their provisions are specifically enshrined in United States statute law.

To return to a theme that I set out at the opening of my remarks, the Contracting Parties set out within the MTN to agree to a new set of laws governing international conduct, and expressed their desire to encourage a greater recourse to dispute settlement mechanisms rather than to political action in the event of disagreements. One would have expected that the wish to create new rules and to enable their enforcement would be reflected as well in domestic law. The greater the opportunity given to private parties to seek review of complaints and to have disputed matters reconsidered, the sooner will this area of stated policy be converted into an accepted body of law for the guidance of governmental authorities.

5. A Suggested Dispute Settlement Procedure for Canada and the United States

If the rights accorded to traders under the public law of the two countries are not considerable, I think it would be well worth considering a bilateral procedure between the two states that could be of significance in resolving disputes under the MTN codes.

There have been considerable efforts during the course of the century to create institutions for problem resolution between Canada and the United States. From the literature examining Canada–United States' efforts to create institutions for managing regional problems,[10] some generalizations may be made. The first is that when an institution has been established between the two governments to deal with matters of high policy, such as ministerial committees to resolve economic problems, it has not worked. Ministers are in politics and refuse to be confined to the Procrustean bed of a single institution. They need more manoeuvrability than a bilateral committee can provide.

Conversely, where an issue involves an immense amount of detail, humble detail, and calls for a high order of expertise, and where it entails no major political question, bilateral institutions have been successful. The prize exhibit in this respect has been the International

Joint Commission when it has been dealing with questions of technical complexity. My suggestion is that we should draw on that experience and on the experience of the panels under the GATT to create a Canada–United States Trade Commission for resolving disputes in Canadian-American trade problems.

The GATT panel system has been described as follows:

> The practice in recent years has been for the GATT Council, on receipt of a complaint following a breakdown in bilateral consultations, to establish a Panel to examine the complaint and in appropriate cases to make recommendations, particularly if it is claimed that there has been nullification or impairment of GATT rights.
>
> The main aim of a panel is both to get an independent assessment of the facts of the case and to promote conciliation between the parties and withdrawal of the action or measure that was the subject of complaint. Often the recommendations of a Panel, endorsed by the GATT Council, are quickly accepted.[11]

The proposed commission could have three nominees from each of the two countries chosen from among individuals with expertise in the area of the trade practices being dealt with. The commission would not be an arbitral tribunal, but rather it would have the functions of fact finding and of proposing solutions to both sides, but not rendering any judgement between the parties. It would not replace any statutory proceeding provided for under national law. Existing dispute-resolution institutions would continue to be available in each country. No government would be bound by the report, although a unanimous finding of fact and proposals for resolution might limit its room for political manoeuvre. It would be a form of conciliation proceeding directed at achieving an agreed settlement between the parties, normally before other procedures had been used.

The fact-finding role would probably be the most useful element of the procedure. A better definition of the problem by arriving at an agreed-upon set of facts and then publicity, along with some proposals for solution, would provide an incentive for governments to settle a dispute. But there would be, it must be recognized, disputes that would be of such a political nature that members of the panel could not agree, or governments would fail to agree. Those would have to be left to intergovernmental diplomacy, or if diplomacy failed, to the disputes procedure under the GATT itself.

The cross-border volume of trade between Canada and the United States is probably the most important between any two members of the GATT. It is inevitable that cross-border disputes will arise out of the new trade codes. A readily available procedure for conciliating trade issues could quickly build up a body of precedents to guide administrations on both sides of the border. If objection be taken that this essentially bilateral arrangement is not consistent with the multilateral nature of the GATT, the response can readily be that there is no reason why it should be confined to Canada and the United States alone. Both countries could willingly extend the facility to their trading relations with the European Community or Japan, for example. For reasons of volume, however, disputes in Canada – United States trade are likely to occur more frequently than in relations with other GATT members.

As a further step in advancing the general body of law on trade matters, and of providing a convenient forum for those involved in trade disputes, I would suggest that the conciliation procedure be available to, and at the instance of, the trader himself, and not just at the will of his government. In this respect, I draw an analogy with the procedure under Article 25 of the European Convention on Human Rights, which permits an individual, as opposed to a government, to lodge a complaint for damages suffered by him against a state that is party to the convention, occasioned by an alleged violation of a right under the convention.[12] Fawcett has observed that this right to take action in an international tribunal accorded to any person, non-governmental organization, or group of individuals is:

> . . . remarkable because it carries the individual beyond the traditional limits upon his status in international law. No longer dependent for the protection of his Convention rights upon diplomatic intervention by the State, of which he is a national, the individual may bring an application against any contracting State, which has made the necessary declaration, even if he is a national of that State, and even if he is not a national of any contracting State; and, in doing so, he exercises not only a procedural right, such as has been granted by other treaties to individuals, but acts in his own behalf to vindicate his own rights and freedoms.[13]

It may be anticipated that the suggestion will not readily be welcomed by the professional diplomats in the Canadian Department of External Affairs or the U.S. State Department who normally claim the exclusive right to conduct transnational negotiations at the government-to-government level. Their concern will be that the lodging of a complaint by a national of country *A* against the government of country *B* will exacerbate rather than quiet the relations between the two states.

As an example, if an intending importer were to lodge a complaint with the commission that the articles for import had been excluded by reason of a regulation on the size of containers contrary to the Agreement on Technical Barriers, would this necessarily worsen relations between the two states? The result of commission consideration would not be binding, would not bring about any direct change in the regulation, or would even suspend its application during the commission's deliberations. But the commission could arrive at a generally acceptable agreement on the facts of the controversy and some proposals for possible solution — two positive contributions to problem resolution that do not always result from diplomatic negotiation.

A further advantage, particularly if the commission came into extensive use, is that resort to the procedure would reduce the scale of the controversy. Where one foreign office presses upon another a protest accompanied by the full minuet of diplomatic negotiation, the prestige of the two states is in high profile. Where a complaint is pressed in a routine way about a pedestrian problem, the scale of the controversy is reduced to the size of the complainant, and, it can be argued, a settlement can more readily emerge without injury to national *amour propre*. The more accustomed that the commercial communities and the public authorities on both sides of the border become to settling individual grievances in this way, the less likely is any such incident to become inflated to an intergovernmental protest.

Furthermore, the importer who has, in his view, been damaged will be less likely to have resolution of his problem tied to some countervailing complaint on a matter totally unrelated to his business. He may avoid the problem of the Canadian hotel keepers who find themselves held hostage for U.S. complaints about Canadian restrictions on advertising on border television stations.

In the initial stages, use of the panel procedure could be commenced modestly and on an *ad hoc* basis, and without the creation of any very elaborate or expensive institution. An exchange of notes between the two governments would be a sufficient legal basis.[14] As private claimants became aware of, and accustomed to, using the panel procedure, a firmer institutional basis, a Canada–United States Trade Commission, could be provided.

Notes

[1] U.S. Senate Report on Trade Agreements Act of 1979, P.L. 96–39, p. 128. U.S. Code, *Congressional and Administrative News*, No. 6A, August 1979 (St. Paul: West Publishing, 1979), p. 136.

[2] 41 U.S.C.A. § 321. *Langenfelder* v. *U.S.*, 341 F. 2d. 600 (1965). J. Davis observed that the General Accounting Office is assured:

> a limited right of scrutiny comparable to (though perhaps not precisely the same as) that given to the courts. ... The Comptroller General has asserted, since the enactment of the statute, the same authority as the courts to disallow payment of a contractor's claims notwithstanding agency decisions in the contractor's favor. ... Where the issue is one of law (e.g. interpretation of the contract), this court has upheld exercises of that power (p. 608).

[3] 1978 Consolidated Regulations of Canada, Vol. VII, c. 701, p. 4715.

[4] R.S.C. 1970, Chapter F – 10. See also Canada, Treasury Board, "Policy and Guidelines on Contracting in the Government of Canada," (Ottawa: 1975); and Canada, Treasury Board, "Procurement Review," (Ottawa: 1980). Government guide-lines on procurement to attain Canadian economic objectives are expressly made subject to Canada's obligations under the MTN.

[5] See *Ben Lance & Sons Ltd.* v. *The Queen* (unreported but referred to [1977] 2 F.C. 764). (Plaintiff given leave to file further statement of claim, limited to claims for misrepresentation and damages on quantum merit — Action in contract not sustainable); see also *Nadeau* v. *The Queen* [1977] 1 F.C. 541. (Action by unsuccessful bidder founded upon provisions of Quebec Civil Code, Article 1053 for misrepresentation by government employees).

[6] 19 U.S.C.A., § 2171, et seq.

[7] Trade Agreements Act of 1979, section 423.

[8] Standards Council of Canada Act, R.S.C. 1970 (1st Suppl.), Chapter 41.

[9] Consumer Packaging and Labelling Act, S.C. 1970 – 71 – 72, Chapter 41 (no right of review of Cabinet decisions prescribing sizes or shapes of containers); Environmental Contaminants Act, S.C. 1974 – 75 – 76, Chapter 72 (provides for a review of a decision of ministers to add a substance to the class controlled under the act, sections 6 and 7, but only at the time of inclusion in the controlled class, not *ex post facto*); Food and Drugs Act, R.S.C. 1970, Chapter F – 27 (no right of review of decision to control); and Hazardous Products Act, R.S.C. 1970, Chapter H – 3, section 9 (where a product or substance is submitted to control, a manufacturer, distributor, or someone having the product in his possession may object and have the order reviewed by a Hazardous Products Board of Review).

[10] See Roger Frank Swanson, *Intergovernmental Perspectives on the Canada – U.S. Relationship* (New York: New York University Press, 1978), Chapter 4. William R. Willoughby, *The Joint Organizations of Canada and the United States* (Toronto: University of Toronto Press, 1979), Chapter 20.

[11] GATT, *The Tokyo Round of Multilateral Trade Negotiations*, Report by the Director-General of GATT, Geneva, April 1979, p. 105.

[12] I am indebted to Professor Hugh Kindred of the Dalhousie Law Faculty for suggesting the analogy. See J.E.S. Fawcett, *The Application of the European Convention on Human Rights* (Oxford: Oxford University Press, 1969), p. 277; and Frede Castberg, *The European Convention on Human Rights* (Leiden: Sijthoff, 1974), pp. 34 – 40.

[13] Fawcett, *op. cit.*, p. 279.

[14] A.E. Gotlieb, *Canadian Treaty-Making* (Toronto: Butterworths, 1968), p. 56.

The GATT and the Deep Structure of Customs Administration

11

by
John Quinn and Philip Slayton

> Let me write the Administrative Act and I care not who writes the rates of duty.[1]

1. Introduction

The principles of customs valuation and their application are important avenues for the expression of national commercial policy. Complex technical changes can raise or lower effective tariff rates, nullifying international tariff agreements; promote trade with some countries and hinder it with others; exacerbate or help eliminate regional disparities within a country. As tariff and non-tariff methods of implementing commercial policy disappear with the increase in international trade agreements, the policy possibilities of valuation became more interesting; hence, no doubt, the Tokyo Valuation Code[2] became inevitable.

In Canada, implementation of the Valuation Code will require substantial new legislation and major changes in administrative procedures. Canada has an unusual opportunity to redesign an important part of its trade apparatus. Important although less radical changes are occurring in the United States. What questions should be addressed as part of these processes?

Any attempt to assess the performance of an institution should proceed from an understanding of its designers' objectives. Judging by recent commentary on the Tokyo Round's non-tariff barriers codes, there seem to be at least two distinct conceptions of the objectives that were pursued by the negotiating parties. One might characterize the first of these conceptions as the "countervailing objectives" view. For example, Sir Andrew Shonfield has recently suggested that "in the context of the mixed economy . . . governments . . . find themselves under pressure to do a variety of things — in the promotion of the social welfare of disadvantaged groups; in regional policy; in creating fresh opportunities for employment in a period of slower economic growth — that impinge on the interests of other states which depend on free access for their trade to the market that is being interfered with."[3] Shonfield suggests that the GATT agreement on public procurement is the most recent example of attempts "to accommodate the interventionist activities of the state in a mixed economy to the need for a predictable and orderly set of rules governing transactions with the international community."[4]

A second and competing conception holds that the negotiating parties shared a consensus view on the desirability of further trade liberalization, but were constrained in their ability to achieve this goal by domestic political considerations. This second conception can be characterized as the "shared goals subject to constraints" view. Gilbert Winham's analysis of the non-tariff negotiations reflects this alternative view:

> The general thrust of the code negotiations was to increase the openness and nonarbitrariness of the rules governing the international trade, with the result that such trade would be facilitated. In some areas this was accomplished without appreciable controversy. For example, in the codes on customs valuation, import licensing and standards, nations proceeded from the widely shared philosophy that non-trade related government regulations should not be used to provide protection for domestic producers, either through design or otherwise.[5]

These competing views possess real analytic value, and do not merely express a semantic difference. The "conflicting goals" model of the GATT focuses on the accommodation of competing interest groups and the process of compromise that animates pluralistic decision-making processes; this conception takes the GATT as an aggregation of many national social welfare functions, with each ascribing some peculiar weight to economic efficiency and security from foreign competition. On the other hand, the "shared goals subject to constraints" model would appear to accept the GATT's formally articulated goals at face value. It assumes general consensus in support of trade liberalization, with certain domestic political interests waging an obstructionist campaign to block further progress towards the widely shared goal of maximizing world wealth. Much of the writing about the GATT's general design has focused on this conflict between competing views of its essential nature — the conflict between the GATT's aspirational and pragmatic features.[6]

While there is some truth in each of these two views of the international regulation of commercial policy, we believe that much of the apparent conflict can be explained if a distinction is drawn between the transnational politics of multilateral negotiations and the domestic politics of implementing GATT obligations. The implementation of the Tokyo Round's non-tariff codes will involve not only the legislative politics of transforming the codal standards into domestic legislation but also the administrative politics of case-by-case application and rule making. This paper argues that the negotiating parties' success in moving towards the GATT's stated goal of neutralizing all non-tariff barriers to world trade should be at least partially gauged by the impact of the codes on the national administrators of commercial policy. We argue that the Valuation Code could be a more effective instrument of liberalization if it were expanded to regulate the administrative institutions that virtually all trading nations use to enforce their customs laws.

Prior to the Tokyo Round, no single international system governed the valuation of goods for customs purposes. Article VII of the GATT contains a few basic principles of valuation, but these standards are broad and open-textured enough to accommodate a substantial diversity in national valuation practices.[7] Early in the Tokyo Round, the negotiators agreed to abandon their existing customs valuation systems and to attempt the formulation of a new uniform system. The search for uniformity forced the negotiating parties to focus their attention on "first principles" — the basic criteria for evaluating alternative customs systems. The negotiating history of the code suggests that most of the parties shared a substantial consensus on the fundamental requisites of a desirable customs system.[8] Most of the formulations advanced in the negotiations included, in some form or another, the four canons of taxation attributed to Adam Smith — equality, certainty, convenience, and economy. Many prior analyses of customs valuation and administration had adopted similar criteria. For example, in 1924 the International Conference on Customs and Other Similar Formalities listed five characteristics that customs procedures must possess if they are to avoid the imposition of economically unjustified barriers to international trade — publicity, simplicity, expedition, opportunity of appeal to an independent tribunal, and equality.[9] The preamble of the new Valuation Code appears also to embrace the Smithian criteria; the preamble states that the code has been designed to promote allocative neutrality, uniformity, and equal treatment of goods from different countries of export. Allocative neutrality seems to incorporate the related objectives of uniformity and non-discrimination, since a perfectly neutral valuation standard will also be perfectly uniform and even-handed in its distribution of the tariff burden. Moreover, allocative neutrality in customs valuation is closely connected with the overriding economic aim of the GATT — the elimination of national policies that distort world trade flows and misallocate resources. An allocatively neutral valuation system takes as its objective the ascertainment of all the real economic costs casually attributable to the production and distribution of imported goods; this approach ensures the avoidance of any distortion of relative prices due to the over- or under-assessment of real economic values. Thus one might characterize the code's primary substantive objective as the design of a "second-best" tariff system that minimizes the allocative efficiency losses attributable to customs duties.

Several features of the Valuation Code reflect a concern for allocative neutrality. For example, the code adopts the real exchange or transaction price agreed to by the parties as the preferred standard of customs valuation, and it prohibits the use of economically arbitrary valuation standards such as the "American Selling Price" method and the Canadian practice of statutorily prescribing minimum value for duty. Another example is the code's treatment of valuation methods that may influence the organizational strategies of trading firms. The code prohibits the adoption of methods that select the highest of several possible values for tariff purposes. For example, the existing Canadian legislation selects as the value for customs purposes the higher of either the sale price of the goods in the exporter's home country at his normal trade level or the actual price at which the goods are sold to Canadian importers at a similar trade level.[10] Since non-arm's-length transactions are generally disregarded for valuation purposes, some firms trading into the Canadian market have established Canadian selling agencies or distributorships to avoid selling their products at the same level at which they sell in their home market. This practice deprives customs officials of any objectively verifiable transaction price for comparison with the price at which the goods are sold in the exporter's home market. In this way, valuation practices may create tax-avoidance incentives to organize the distribution of imported goods in an economically inefficient way. An allocatively neutral system will minimize incentives for the inefficient organization of production and distribution.

The main argument of this paper is that the Customs Valuation Code falls far short of satisfying Smithian standards in its treatment of the appropriate relationship between allocative neutrality and customs valuation procedure. An economically ideal system of customs valuation would reflect some optimal trade-off between private and public costs of compliance and the marginal improvement in the accuracy of valuation determinations resulting from additional expenditures of private and public resources. The public costs associated with a scheme of customs valuation include the direct costs of investigation, enforcement, and dispute resolution. Private parties incur both compliance costs and uncertainty costs. Compliance costs include the expense of assembling information to support valuation claims and litigation expenses. Uncertainty costs are created primarily by the fact-specific nature of the decision-making process in valuation systems. The application of valuation methods turns on highly individuated factors, such as the distribution of selling prices between the parties, royalties, and purchaser assists. Additional uncertainties arise from rapid changes in administrative regulations about the quantity and quality of price information required to support the importer's declared value.

Procedural mechanisms that structure the valuation decision-making process greatly influence the allocation of costs between the public enforcement bureaucracy and private traders. For example, a rule imposing the burden of proof on the importer in valuation disputes will reduce the public enforcement costs while at the same time imposing added costs on importers, who will increase their efforts to prevent negligent misstatements on customs invoices. It is this cost-allocating maze of procedural rules governing customs valuation systems that we refer to as the "deep structure" of customs administration. Our criticisms of the Customs Valuation Code are focused, not so much on its failure to address allocative efficiency in customs valuation, but rather on its failure to penetrate the deep structure of the valuation decision-making process. We argue that the code should be expanded to regulate the procedural design of national customs administration systems.

2. The Customs Valuation Code

A. Standards of Valuation

While the theory of valuation is simple, the application of valuation principles is complex, involving many fact-specific determinations that require subjective judgement. The Customs Valuation Code[11] attempts to minimize the necessity for detailed applications by establishing "transaction value" as the preferred method of customs valuation. "Transaction value" is defined as "the price actually paid or payable for the goods when sold for export to the country of importation" (Article 1:1). The code provides that methods other than transaction value may only be used in certain narrowly circumscribed situations. The most important exception to transaction value is non-arm's-length sales between related parties. In order to simplify our analysis, we shall divide our discussion of the code's valuation standards in terms of whether or not the import transaction occurred between related parties.

In an arm's-length sale of imported goods between unrelated parties, the actual transaction price will be the value for duty unless the sale occurs under circumstances that render the actual consideration paid by the buyer incapable of objective determination. For example, when the price to the buyer depends upon the price at which he sells other goods to the exporter (a reciprocal buying situation), no objective transaction price can be ascertained. Another example is a contract for sale under which some indefinite portion of the proceeds of resale would be rebated to the seller. As an illustration of this, assume that the buyer agrees to pay a royalty on the basis of the resale price of a particular product that was imported by the kilogram and transformed into a solution for resale purposes. Since the royalty is based partially on the imported product and partially on other factors unrelated to the imported product, it would be impossible to make a determinate adjustment to the transaction price to reflect the additional cost of the royalty to the buyer. It is only those transactions for which adjustments to the invoice price cannot be quantified accurately that will require valuation under some alternative method. To take a common example, when the buyer provides an "assist" in the form of components or know-how, the transaction price will be adjusted upward to reflect the nominal cost of that assist unless the buyer is unable to furnish accurate evidence to establish his real cost of providing the assist. In regard to transactions between non-related parties, the code's primary beneficial effect is to narrowly circumscribe the discretion of customs officials to adjust or reject the price negotiated by the parties.

In those unusual circumstances in which the actual transaction price between non-related parties cannot be established, the code first provides that the value for duty shall be the transaction value of identical (or similar) goods sold for export to the same country of importation.[12] The code expressly permits the use of comparison transaction prices based on export sales at different commercial levels or in different quantities than those for the goods being valued. For example, if the comparison sales were to regional wholesalers but the imported goods were sold to a national distributor, the additional costs and profits attributable to the subordinate level of distribution would be subtracted from the comparison sales prices for the purpose of determining the value of the imported goods. Here the code's liberalizing effect is mitigated by the requirement that the importer provide verifiable "evidence that clearly establishes the reasonableness and accuracy of the adjustment" (Article 2(b)). If customs officials decide that the evidence adduced is insufficient, they may insist on the use of alternative valuation methods.

If there are no export sales of like or similar goods, or if there are such sales at different trade levels and at different quantities and there is insufficient evidence to adjust prices for comparison purposes, the importer may choose between two alternative methods — deductive value or computed value. Article 5 provides that the deductive value of imported goods is the unit price at which the goods to be valued (or at which identical or similar imported goods) are sold in the country of importation in the largest aggregate quantities to unrelated persons. Under the alternative computed value method of Article 6, customs value is the sum of the cost or value of materials and fabrication or other processing employed in producing the imported goods, plus an amount for profit and general expenses equal to that normally reflected in the sales of goods of that class or kind. The code provides that the deductive value method of Article 5 will take precedence over the computed value method of Article 6 unless the importer switches the order of precedence. When might the importer choose to do so? One consideration relates to the source of data to be used for valuation computation under the alternative methods. The Article 6 computed value method requires extensive information on the exporter's cost of production and profits. If the importer is not related to the exporter, he may encounter difficulty in obtaining the required information, either because the costs of securing the required evidence are high, or because the exporter refuses to co-operate.[13]

In some circumstances, the right of election between deductive and computed value may be of little benefit to the importer. Article 5 of the code permits the calculation of deductive value based on the subsequent sale price of the imported goods in the country of importation subject to downward adjustments for differentials in quantity and trade levels. The Article 6 computed value calculation arrives at value for duty by determining the exporter's cost of production and profits and then adding selling expenses and costs associated with preparation for shipment. When the deductive value calculation is based on the imported goods, it seems that both methods will lead to precisely the same value for duty. Article 5 begins at a subsequent trade level and works backward; Article 6 begins with cost of production and works forward. The importer's right to elect between Articles 5 and 6 may have significance when the deductive value calculation under Article 5 is based, not on the transaction prices of the goods being valued, but rather on the sales prices of identical or similar goods. The code's definition of "similar" goods focuses on "commercial interchangeability," and this standard may permit comparisons between goods possessing significant quality differences.[14] If the comparison sales employed in the deductive value calculation are of goods of a higher quality than that of the goods being valued, the deductive value method may lead to a value for duty substantially greater than that reached under the alternative computed valuation method. For example, if the imported goods are low-quality bicycles and the importer fears that the customs officials will insist on comparisons with transactions prices for "similar" bicycles of a higher quality in arriving at the deductive value, he may choose to elect valuation under the computed value method of Article 6.

The right of election between Articles 5 and 6 appears to give the importer greater control over the valuation process, but the code undercuts this strategic advantage by imposing upon him the onus of proof. If the importer fails to supply evidence deemed sufficient by customs officials to establish a verifiable value based on either computed or deductive value, the officials may insist upon the application of the method not favoured by the importer.

When the importer is unable to establish a value for duty under either Articles 5 or 6, Article 7 of the code provides that reasonable alternative methods, "consistent with the principles of this Agreement," must be employed for valuation purposes. The interpretive note to Article 7 in Annex 1[15] to the code states that "the methods of valuation to be employed under Article 7 should be those laid down in Articles 1 to 6." At first blush this directive seems odd; since the code's valuation rules are sequential in application, the "reasonable methods" standard of Article 7 can only be employed when the standards in Articles 1 to 6 are inapplicable. However, other interpretive notes to Article 7 suggest that the drafters envisaged modifications in the preferred valuation standards of Articles 1 to 6 as the basis for valuation under Article 7. For example, assume that identical or similar imported goods are not produced in the country of exportation, so that Articles 2 and 3 are inapplicable. Assume also that the deductive and computed value methods are inappropriate because of lack of objective proof. Under these circumstances, the reasonable methods test of Article 7 would permit comparisons with the transaction prices of identical or similar goods manufactured in a country other than the country of origin of the goods being valued.

The second paragraph of Article 7 enumerates valuation methods deemed unreasonable regardless of the circumstances. This paragraph prohibits arbitrary valuations based on the following:

a. The domestic price of similar or identical goods produced in the country of importation
b. Arbitrary "tie-breaker" rules that require the selection of the higher of two alternative values
c. The domestic selling price of the goods in the country of origin
d. Cost of production methods other than under Article 6
e. Minimum customs values or "arbitrary or fictitious values."

As we discuss later in this essay, Article 7 proscribes virtually all the valuation methods currently employed by Canadian and American customs officials. The express prohibitions in Article 7(2) prevent the re-introduction of many existing Canadian and American valuation methods as "reasonable means" of valuation when Articles 1 to 6 are inappropriate.

The parent-subsidiary relationship between an exporter and an importer (or any other significant relationship in which control factors make suspect the legitimacy of a reported transfer price) is a ubiquitous feature of modern trading arrangements. For example, approximately 50 per cent of the trade between Canada and the United States occurs between related entities.[16]

The reform of valuation principles applicable to non-arm's-length transactions was a major negotiating objective of the code's signatories. Paragraphs 2(a) and 2(b) of Article 1 govern the acceptability of transaction values in sales between related parties for valuation purposes. Paragraph 2(b) permits the importer to establish that the transaction value closely approximates "test values" established by the code. These "test values" include sales prices to unrelated buyers of similar or identical goods in export sales to the same country of importation, or the deductive or computed value of identical or similar goods exported to or imported by that country. Paragraph 2(b) allows these values to be adjusted for "demonstrated differences in commercial levels, quantity levels . . . ," and for costs incurred by the seller in his transactions with unrelated buyers that are not incurred when he sells to related parties. Paragraph 2 also provides that "test values" are to be used only "at the initiative of the importer and only for comparison purposes." The test values may not be employed as substitute valuation standards; they are simply evidence of "the real transaction value" attributable to the non-arm's-length sale. Paragraph 2(a) of Article 1 supplements the provisions of paragraph 2(b); it provides that when reliable "test values" cannot be established for the non-arm's-length sale, the importer must neverthless be accorded a reasonable opportunity to show that the relationship between buyer and seller did not materially affect the transfer price. Thus, the combined effect of paragraphs 2(a) and (b) is to impose significant limitations on the discretion of customs officials to reject reported transfer prices as an appropriate basis for valuation in transactions between related parties.

If the transaction value standard of Article 1 cannot be applied in a non-arm's-length sale situation, the administering authorities must proceed sequentially through the remaining articles, just as they would in an arm's-length transaction. In many cases where the imported goods are components or are imported for further processing in the country of importation, the valuation methods prescribed by Articles 2 and 3 will be inappropriate. In these circumstances, the importer will be confronted with the choice of the deductive or computed methods of Articles 5 and 6. As regards sales between related parties, the code's provision for an alternative deductive value standard will effect a substantial reform in the valuation methods currently employed by many countries. For example, existing Canadian and U.S. laws generally require a computed value approach in these circumstances. Under the deductive method of valuation established in Article 5, the cost of further processing in the country of importation can be subtracted from the sales prices of the goods in their fully manufactured condition. The election of the deductive method may be advantageous to the importer if relatively minor additional processing or fabrication is undertaken in the country of importation, since deductions from the sales price of the goods in their finished condition will be relatively small and few in number.

Finally, one of the most significant features of the code's valuation scheme is the provision of Article 8 authorizing each Contracting Party to adopt either a c.i.f. or f.o.b. valuation system. This unrestricted discretion to adopt values including or excluding freight and insurance encourages divergent commercial practices that increase the transactions costs of international trade. Moreover, allocative neutrality seems to require a uniform valuation base, whether f.o.b. or c.i.f.

Both Canada and the United States employ an f.o.b. system. Caroline Pestieau has estimated that change from an f.o.b. to a c.i.f. system would increase the average amount of duty payable by approximately 8 to 10 per cent.[17] Pestieau made these additional observations about Canada's f.o.b.-based valuation system:

> The adoption by Canada . . . of a "free-on-board" (f.o.b.) valuation system favours those exporters who are at a greater distance from Canada and thus discriminates, to a certain extent, against the United States. The f.o.b. system tends towards the equalization of the competitive advantage in the Canadian market of countries situated at different freight distances from Canadian importers. It also evens out the tariff burden within Canada. Under a c.i.f. system there would be a differential between the duty payable by importers on the coast or near the U.S. frontier and that payable by importers in the central and northern parts of the country (unless the latter accepted the inconvenience and the risk of having their goods cleared in their absence at frontier and coastal ports). Furthermore, c.i.f. valuation entails changes in the tariff burden following changes in the world shipping market and hence in freight rates, while f.o.b. valuations give greater stability to tariffs.[18]

While there is wide agreement on these points, it might be better to emphasize an f.o.b. system's tendency to "equalize competitive advantage" rather than its discriminatory effect against the United States. Even from this "affirmative action" perspective, however, it is clear that the selection of a particular valuation basis may be employed for discriminatory purposes. Moreover, the stability arguments in favour of an f.o.b. system lose force in a world of substantial exchange rate fluctuations and other major uncertainties.[19]

B. Dispute Resolution and Administration

Part II of the code sets forth a dispute resolution mechanism. A Committee on Customs Valuation offers consultation opportunities (Article 18), investigates disputes (Article 20), establishes panels (that are governed by the procedures set forth in Annex III) to investigate disputes, and takes "appropriate action" upon receipt of panel recommendations. What is "appropriate" is not specified, but the most Draconian remedy available seems to be that set forth in Article 20(9):

> If the Committee considers that the circumstances are serious enough to justify such action, it may authorize one or more parties to this Agreement to suspend the application to any other party or parties to this Agreement of such obligations under this Agreement as it determines to be appropriate in the circumstances.

A Technical Committee on Customs Valuation (Article 19) is charged with promoting technical uniformity in the interpretation and application of the agreement (Annex II, paragraph 1), and investigating technical disputes when asked to do so by the Committee. Article 20(7) apparently precludes the Committee from taking "appropriate action" upon receipt of Technical Committee reports ("With respect to panel reports, the Committee shall take appropriate action . . .").

This type of dispute resolution and enforcement apparatus is familiar to students of the GATT. There is considerable GATT experience in the use of panels, and retaliation has been an available enforcement mechanism (under Article XXIII) for some time. Robert Hudec, speaking of the period after 1960, has referred to "a sharp decline in the utilisation of the panel procedure by most governments" and to "increased levels of resistance and unpleasantness found in recent proceedings that have been brought."[20] He has argued that "new and better substantive rules will not necessarily result in increased government compliance."[21] On the other hand, as Hudec has also pointed out, "a structure of international rules provides a prompt and effective way to package and transmit GATT policy to government officials" and will probably have an effect on domestic decision-making processes.[22] As for retaliation, although the possibility may have symbolic value, that may be about all; there has only been retaliation under Article XXIII once in the GATT's history (in 1952 the Netherlands was authorized to impose quantitative restrictions against the United States). Consideration of dispute resolution after the Tokyo Round is beyond the scope of this essay, but, in light of criticisms of existing procedures made before and during the Tokyo Round, one might anticipate significant disappointment and continued tendencies towards non-compliance.

C. Canadian and United States Law in Light of the Code

Canadian Law

It is clear that sweeping changes in the Canadian valuation scheme current at the time of writing (summer 1980) will be necessary to implement the code's transaction price standards. The present Canadian valuation rules accord precedence to values based on the sales prices of like goods in the exporter's home market to non-related purchasers at the same trade level as the importer. Many adjustments to the export market price authorized by the legislation are patently biased against importers. For example, if there are no non-related purchasers in the domestic market of the country of export who bought at the same trade level as the importer, export market sales at trade levels subsequent to that of the importer will be adopted as the valuation base. Again, under section 36(2)(e)(i) of the Customs Act, when the imported goods are sold in a quantity larger than the largest quantity sold in the country of export, the quantities " . . . .are deemed to be the same quantities . . . " in calculating the valuation base. Such arbitrary rules are inconsistent with the code's requirement that all adjustments to comparison sales at different trade levels and in different quantities be supported by "demonstrable evidence" establishing a bona fide commercial justification for the adjustment.

Under existing law, if "like goods" are not sold in the domestic market of the country of export under the conditions prescribed in section 36, the value for duty must be calculated by reference to the computed value of "similar goods" produced in the country of export. Section 37 of the act provides that when similar goods are sold under the conditions prescribed by section 36, the value for duty is the aggregate of the cost of production and "an amount that is the same percentage of the cost of production of the goods imported as the gross profit on the similar goods is of the cost of production of the similar goods." This computed value standard is similar to the valuation method established in Article 6 of the code.

An essential feature of present Canadian law is its emphasis on ministerial prescriptions as the primary residual method of valuation when the standards provided by sections 36 and 37 are inapplicable. Section 39 authorizes the minister to prescribe a method for valuation when he "is of the opinion that by reason of unusual circumstances the application of sections 36 and 37 is impracticable." Moreover, section 40 of the Customs Act provides:

> Where sufficient information has not been furnished or is not available to enable the determination of cost of production, gross profit or fair market value under section 36 or 37, the cost of production, gross profit or fair market value, as the case may be, shall be determined in such manner as the Minister prescribes.

The combined effect of sections 39 and 40 is to confer broad discretion on the minister either to prescribe the method for valuation when the standards provided by sections 36 and 37 are deemed inappropriate or, alternatively, to require valuation of the goods under either section 36 or section 37 with such modifications to the statutorily prescribed standards as the minister finds appropriate under the circumstances. Legislation to implement the code will have to cut back these explicit and general discretionary powers severely. Only Article 7 of the code ("reasonable means") authorizes the exercise of discretion similar to that now possessed by the minister. But Article 7(2)(g) of the code expressly prohibits the use of "arbitrary or fictitious values" and, as we have seen, the interpretative notes to Article 7 assert that the method of valuation prescribed under Article 7 should be derived from the methods provided in Articles 1 to 6.

Finally, section 41 of the existing legislation imposes a "minimum value" requirement. It provides that when the actual transaction price declared on the invoice is greater than the value for duty established under any of the other provisions of the act, the reported sales price must be adopted as the basis for valuation. This minimum value rule must be repealed when the code's provisions are implemented, since Article 7(2)(f) explicitly proscribes the use of "minimum customs values." We indicated earlier how the minimum value rule of section 41 creates perverse tax avoidance incentives for the organization of imported goods distribution through related selling agents.

Canada has not accepted the obligations of the Customs Valuation Code unconditionally. Ambassador J.H. Warren, Canadian Coordinator for the Multilateral Trade Negotiations, has indicated the nature of the government's reservations:

> As this agreement will require Canada to make fundamental changes to our customs legislation and administrative practices, our willingness to bring the current Canadian valuation system into conformity with it has been made conditional on it being understood by our main trading partners that we would be able to take measures to offset any significant loss of protection which might result and that we would have four years to effect the changeover to the new system.[23]

In August 1980, the minister of finance directed the Tariff Board to undertake a review of draft legislation on customs valuation and to study the impact of the proposed legislation on Canadian customs duties.[24] What appears mostly at issue in this reference is what compensating increases in rates of duty are necessary to offset decreases in tariff protection as a result of decreases in the valuation base; the Board has been asked to report on that issue by 1 July 1983. At the same time, the Department of Finance published the text of proposed legislation and regulations to implement the Customs Valuation Code.[25] Detailed evaluation of these draft amendments to the Customs Act and draft regulations is beyond the scope of this essay. Broadly speaking, the proposed amendments mirror the code by providing the actual transaction value as the value for duty, and where that is not possible, sequential reliance on the transaction value of identical goods, the transaction value of similar goods, deductive value and computed value (see the proposed section 36), with the importer being free to reverse the order of consideration of the last two. As a last resort, the proposed new section 42 roughly reflects Article 7 of the code. The draft amendments do not provide for arbitrary adjustment rules, ministerial prescriptions, or minimum value requirements of the sort found in the existing legislation.

United States Law

Before 1979, there were two statutory valuation systems in effect in the United States. The first, applicable to most imported merchandise, was the old section 402 of the Tariff Act of 1930, as amended by the Customs Simplification Act of 1956.[26] The other, found in section 402(a) of the Tariff Act, was applicable to articles on the so-called "Final List" published by the secretary of the treasury pursuant to section 6(a) of the Customs Simplification Act.[27] This two-tier valuation system arose from a major revision in United States customs valuation standards that took place in 1956. Before the enactment of the Customs Simplification Act of that year, the secretary of the treasury was instructed to prepare a list of commodities which, if appraised under the new valuation standards, would have been valued at 95 per cent or less of the value at which they were actually appraised in the twelve months ending 30 June 1954. The articles so listed by the secretary were published in a "Final List" and continued to be appraised under the standards in effect before 1956.

Under section 402 of the amended Tariff Act, imported merchandise was valued according to the following standards applied sequentially: (1) the export value of the imported goods; (2) if the "export value" could not be ascertained, the "U.S. value"; (3) if neither the export nor the U.S. value could be employed, then the "constructed value." In addition, for a certain limited number of articles that had been specified by presidential proclamation pursuant to section 336 of the Tariff Act, the American Selling Price method was used for valuation.[28]

For the purpose of section 402, the "export value" of imported goods was defined as the usual price at which such or similar goods were freely sold, in the principal markets of the country of exportation, in the usual wholesale quantities, for exportation to the United States. Under the new code, such a standard would have several objectionable features. First, a reference to prices in the country of export is specifically proscribed by Article 7(2) of the code. Secondly, under the old "export value" standard, when a commodity was sold at varying prices depending upon the quantity purchased, the statute prescribed that the usual wholesale quantity would be that quantity in which more of the goods were sold than any other quantity. The code now requires customs officials to make adjustments for trade and quantity levels based on all objective information available.

Under the old system, when export value could not be used to calculate value for duty, for example in related party transactions where the Customs officials doubted the legitimacy of the import invoice, the goods were valued in accordance with the "U.S. value." The "U.S. value" was defined as the price, at the time of exportation, at which such or similar merchandise was freely sold in the United States for domestic consumption, in the usual wholesale quantities, with deductions for selling commissions, normal profit and selling expenses, costs of transportation and insurance from the country of origin, and customs duties and federal excise taxes imposed after importation.[29] When the selling prices of the goods being valued could not be used to compute "U.S. value," because the goods were imported for further processing and hence were not sold as imported in the domestic U.S. market, the selling prices of like or similar goods produced in the country of export and sold in the U.S. market were used in the calculation.

If neither the imported goods nor such or similar imported goods were sold in their imported form, section 402 provided that the "constructed value" should then be used. "Constructed value" was the sum of the cost of materials and processing employed in producing such or similar merchandise in the country of origin, plus an amount for normal profit and general expenses.[30]

The American Selling Price system, which as we have mentioned applied to a limited number of imported goods pursuant to presidential proclamation, was defined as the domestic selling price of *such* goods manufactured or produced in the United States. If the imported goods were similar but not identical to goods produced in the United States, the American Selling Price value could not be used and valuation was determined under the normal rules of section 402. The code, in Article 7(2), expressly proscribed valuation based on the selling prices of goods made or produced in the domestic market of the country of importation.

Goods on the "Final List" were valued under section 402(a) of the amended Tariff Act. The valuation standards were similar to those of section 402 with one important exception. Section 402(a), unlike section 402, contained a tie-breaker rule providing that the first basis to be applied for value for duty would be the higher of the "foreign value" or the "export value." "Foreign value" was the usual domestic price of the imported goods in the country of origin. "Export value" had a definition similar to that provided by section 402 (selling price in the country of origin for export to United States).[31] The code proscribed the adoption of any such tie-breaker rule.

The Trade Agreements Act of 1979 has implemented the code's provisions, almost word for word, into U.S. law.[32] How exactly this new law will work depends in good measure upon the regulations made pursuant to the act; analysis of these voluminous and complex regulations is beyond the scope of this essay.

3. The Deep Structure of Customs Administration

Customs laws are generally administered through informal processes in which front-line officials bear most of the responsibility for monitoring compliance and verifying information supplied by importers.[33] Decisions on value for duty and many other matters are taken without a formal record, without an opportunity formally to test the validity of information, without articulated support for decisions, and by someone other than an independent decision maker. This lack of procedural safeguards is justified by the nature of customs administration. Many of the functions performed by front-line Customs officials could not be carried out through adjudicatory proceedings without imposing an unacceptable cost on public and private resources. Thus, the informal procedures employed by most customs bureaux permit rank-and-file officials to take action without demonstrating to an impartial adjudicator that the information they rely upon is accurate, and that their interpretations of the relevant statutes and regulations are correct. On the other hand, much of the customs administration process involves the application of general standards to specific cases; Customs inspectors, district supervisors, and import specialists at the bureau's headquarters constantly make decisions by applying standards to particular fact situations. Tension exists between the need for efficiency and flexibility in this process, and the need for procedural safeguards to ensure fair and accurate determinations. Most customs administration systems resolve the tension by combining informal decision-making procedures with judicial review for those who are aggrieved.[34] After duties are assessed informally, the importer may petition the head of the relevant customs bureau for a change of decision, and if the petition is denied, take an appeal to a judicial or quasi-judicial tribunal. At the appeal stage, the review process is usually a hybrid of appellate review and *de novo* adjudication. The appellate tribunal does not review an administrative record; decisions are based on a record compiled *de novo* at the appeal hearing. But the right to judicial review accorded by most customs administration systems is not, in a full sense, a trial *de novo*, since the tribunal does not make an independent determination of contested issues. Instead the decision of the customs bureau is assumed to be correct and the importer carries the burden of proving that the decision is erroneous.

The code says little about procedural design for customs administration. We asserted earlier that the code's primary deficiency is its failure to penetrate the "deep structure" of protection, found in the procedural design of most existing customs administration systems.

For example, there are features of the Canadian and American systems that permit Customs officials to impose heavy costs of compliance and uncertainty on importers, without any apparent justification based on some trade-off between the accuracy and efficiency of the decision-making process. Many of these procedural mechanisms are defended on the grounds that they are necessary to "protect the revenue" or to minimize public enforcement costs. These arguments overlook two points: (1) these rules may generate private compliance costs substantially in excess of the marginal increase in decisional accuracy or savings in public enforcement costs that they secure; and (2) these procedural mechanisms generate losses in allocative efficiency because the added compliance and uncertainty costs that they impose deter transactions that would secure welfare gains from trade. Since the mechanisms in question cannot be defended on efficiency grounds, it seems likely that their real purpose is protection.

A. Exchange of Information

Under existing Canadian and American customs law, an importer has no right to compel the disclosure of information that has been gathered by the customs service from domestic and foreign sources. Much of the information relevant to a valuation dispute will be provided to Customs officials by domestic producers, or it may be secured through customs investigations in the exporter's home market. The accuracy and reliability of this information cannot be tested by the importer's counsel in a formal adversary proceeding until the judicial or quasi-judicial stage of the appellate process.[35] While importers are usually afforded an opportunity to consult with Customs officials on an informal basis, Customs has no obligation or incentive to provide any detailed disclosure of the facts and opinions upon which it proposes to rely in reaching its internal decision. Moreover, the procedures employed by the deputy minister or the secretary to review formal protests or petitions for ministerial review are highly informal, and the degree of disclosure afforded the importer is wholly a matter of administrative discretion. The importer is also disadvantaged by the fact that the internal appeal process does not culminate in a decision supported by written reasons of sufficient detail.[36] While existing customs practice generally does provide some articulated grounds for the final administrative determination, in most circumstances written decisions do not provide sufficient factual and legal detail to clarify Customs' probable stance in future litigation.

The importer's lack of a right of access to material information in Customs' files during the pendency of the internal review process and his inability to secure a clear written statement of Customs' legal and factual position substantially increase compliance and uncertainty costs. First, most disputes over valuation involve highly particularized and fact-specific issues, such as the appropriateness of various cost-accounting formulae in the determination of profits and expenses, or the issue of whether comparison sales involved "identical" or "similar" goods. Disclosure of information at an early stage in the internal review process would provide an opportunity for the minimization of wasteful disputation over factual issues at later stages, and both reduce the costs of litigation and decrease the likelihood of groundless importer appeals. Secondly, and more importantly, the fact is that the importer has no opportunity under the present scheme to adequately test the reliability of data gathered by Customs unless he decides to initiate judicial review of the final internal decision. Thus, he must rely on Customs personnel to verify complex data that are often obtained from exporters in foreign countries. A reasonable opportunity to challenge the accuracy of the information obtained by customs may reveal deficiencies in the factual basis of Customs' position and lead to a settlement or termination of the dispute. Thirdly, the importer requires a reasonably detailed statement of Customs' legal and factual position in order to prepare a well-focused critique at the terminal level of the internal review process, and to make an informed decision concerning the likelihood of success in a proceeding for judicial review. Since the costs of seeking judicial review are usually substantial, uncertainty concerning the basis of an adverse decision may deter meritorious appeals or, conversely, when the importer's stakes are high, encourage frivolous appeals.

For the above reasons, it would seem desirable to require written decisions with reasonably detailed reasons at the final stage of the internal review process. The costs of compliance and uncertainty would be further reduced by a requirement that Customs officials disclose information not otherwise available at reasonable cost to the importer in a conference with the importer's counsel prior to the final stage of internal review. The informal nature of the conference would entail a relatively minor increase in public enforcement costs while it is likely to confer substantial benefits in decisional accuracy and avoidance of wasteful litigation. While Article 16 of the code now incorporates a right to written reasons justifying the valuation method employed, it fails to specify at what stage of the administrative process, if any, written reasons may be required and the required amount of detail to be provided.[37]

B. Unreviewable Discretion

Article 11 of the code provides for a "right of appeal without penalty to a judicial authority" in customs valuation disputes. But Article 11 is ambiguous and uncertain. First, it does not specify at what stage in the administrative process an appeal may be taken. Interim decisions, such as decisions concerning the amount of a surety deposit for estimated duties payable, may be employed by front-line officials to deter trade or discourage resistance to upward revisions in value for duty.[38] Does the right of appeal extend to such decisions? A second ambiguity concerns the scope for review of ministerial prescriptions, authorized as a residual basis for valuation under Article 7 of the code. Existing Canadian law severely limits review of ministerially prescribed values.[39] Article 7 establishes a "reasonable means" test; that suggests some substantive limitations on ministerial discretion. It might be argued that a limited right of judicial review of ministerial prescriptions under Article 7 is envisaged by the code, and that a modification of the Canadian standard of review will be necessary.

C. Standard and Burden of Proof

Under existing American customs law, a plaintiff challenging Customs' action in the Customs Court has a dual burden of proof; he must overcome a statutory presumption that the Customs' action is correct, and then must prove what alternative action would have been correct.[40] If the plaintiff proves only that the valuation method adopted by Customs was incorrect, the decision is nonetheless permitted to stand unless the plaintiff also proves what the valuation method should have been. The presumption of correctness of Customs' decisions arises from 28 U.S.C. s. 2635(a), which provides that in disputes before the Customs Court "the decision of the Secretary . . . is presumed to be correct, and the burden to prove otherwise shall rest upon the party challenging a decision." While this provision does not, on its face, suggest a dual burden, that burden has been imposed by judicial decision.[41]

The standard of proof in valuation disputes is the preponderance of evidence. Proof of valuation, even by a preponderance of the evidence, is an exceedingly difficult task. First, important evidence is often in the exporter's files and may be inaccessible to the importer. Secondly, in most valuation disputes, the disagreement between the parties focuses on the selection of the most representative value from a range of alternative reasonable values. Thirdly, the unfairness of the American approach is increased because Customs need only "estimate" a value for duty on the best available evidence.[42]

Procedural rules that allocate the burden of proof to the importer are unobjectionable if the importer can obtain the required information at less cost than the public enforcers. The dual burden-of-proof rule employed in the U.S. Customs Court, however, has the additional consequence of substantially escalating the standard of proof required in valuation cases. This is because of the fact-specific and complex nature of valuation determinations that, in the "hard cases" most likely to be appealed, invariably require the selection of a particular value from an array of plausible alternatives. It should be noted that the dual burden of proof is not always difficult for the plaintiff to satisfy. When the same evidence can be used to show that the Customs' action was wrong, and to establish the importer's contentions, there is effectively a single burden of proof. For example, if the only issue is whether a buying commission is legitimate (in which case it is not included in value for duty), the same evidence used to rebut the presumption that Customs correctly decided the issue may also establish that the buying commission was correctly excluded from the valuation base.

The high standard of proof implicit in the American dual burden-of-proof rule reduces public enforcement costs by discouraging challenges to Customs' decisions, and by conferring on Customs officials the discretion to insist upon values that fall in the upper range of the reasonable alternatives under consideration. This exacting standard of proof reflects an implicit policy judgement that a decisional bias in favour of higher values will minimize the sum of error and process costs. In other words, it places greater weight on the avoidance of decisional errors that result in undervaluation of imported goods. From an allocative efficiency standpoint, there is no compelling justification for a standard of proof that biases the error rate in favour of overvaluation. In fact, it can be argued that while undervaluation errors impose a revenue loss on the public treasury (i.e., a transfer that does not entail the use of productive resources), they also result in countervailing welfare gains by reducing dead-weight losses attributable to the tariff. A decisional bias in favour of overvaluation augments the misallocative effects of an *ad valorem* tax. It also imposes increased compliance and uncertainty costs on importers, which may exceed the savings that it effects in public enforcement costs. A relatively high standard of proof creates an incentive for the importer to expend more resources in the preparation and verification of information relevant to valuation. Moreover, in cases where most of the relevant data must be obtained from the files of foreign exporters, it would seem that the public enforcers would possess substantial comparative cost advantages in securing the required information, at least in part because verification by Customs personnel in the exporter's home market will be undertaken regardless of the detail and apparent veracity of the importer's evidence.[43]

For these reasons, we believe that the optimal trade-off between error costs and the costs of compliance and uncertainty lies in the direction of reducing the onus of proof imposed on importers by existing American customs law. We propose that the standard of proof in valuation disputes be the preponderance of the evidence test. Importers would be required to prove on a balance of the probabilities that their determination of value is the most reasonable under the circumstances. Since the existing appellate bodies, the Customs Court (and in Canada the Tariff Board), are highly specialized tribunals, there is little basis for the objection that they lack the institutional competence required to undertake a more searching review of administrative decisions.

D. Private Enforcement

Existing American legislation permits domestic producers to initiate judicial review of Customs Service determinations concerning imports that compete with their products.[44] Canadian law gives standing only to the owner or consignee of imported goods.[45]

Private enforcement of customs law might be justified on efficiency grounds if domestic producers possess substantial comparative advantages in detecting undervaluations, gathering supporting information, and litigating value determinations. The real comparative advantage possessed by domestic producers is probably limited to their ability to monitor compliance with valuation standards, and to gather information available in the country of importation. It is unlikely that domestic firms possess any cost advantage over public enforcers in the prosecution of litigation and in information gathering or verification in the country of export. Furthermore, a standing rule that allows domestic competitors to initiate formal review proceedings in valuation cases can be expected to increase compliance and uncertainty costs borne by importers; domestic competitors possess substantial incentives to use the review process as a strategic tool to increase the costs of their importer-competitors. Moreover, participation in the review process by domestic competitors may increase importer anxiety about disclosure of proprietary information.[46]

While there may be justification for the creation of some formal complaint procedure encouraging domestic producers to convey material information to Customs, we believe that the efficiency gains of the existing American standing rule are more than outweighed by the additional compliance and uncertainty costs that it generates.

E. Administrative Penalties

Section 231 of the Canadian Customs Act authorizes the imposition of an administrative penalty equal to the value of the imported goods for either fraudulent or negligent misstatements of value for duty. While there is no published information about how this forfeiture penalty has been used by the Department of National Revenue, the existence of such a penalty raises the general question of the optimal deterrent for undervaluation. An efficient penalty would reflect some optimal trade-off between the public costs of enforcement and the private costs of compliance and uncertainty. This formulation of the design problem assumes the real economic cost of a failure to detect undervaluations is zero because the only consequence of error is a transfer of revenue from the Treasury to the importer.

A heavy penalty for both fraudulent and negligent misstatements reflects an implicit policy judgement that the additional enforcement costs of distinguishing between fraud and negligence would outweigh the savings in private compliance and uncertainty costs that might be avoided.

Such a judgement fails to give adequate weight to the additional costs of compliance and uncertainty created by failing to distinguish between fraud and negligence. Importers can avoid fraud very cheaply; the prevention of negligent misstatements, however, requires importers to expend more resources in gathering and verifying information, often from unrelated exporters in foreign countries. Moreover, the risk of a heavy penalty for negligent undervaluations is likely to induce importers to resolve reasonable doubts on valuation issues by selecting values that are less likely to incur penalty proceedings.

An optimal deterrence scheme would distinguish between negligent and fraudulent undervaluations in the design of penalties. In fact, the American law has recently been amended to create such a distinction.[47] It allows forfeiture of the goods for fraud but limits penalties for negligent misstatements to double the duties otherwise payable.

Notes

[1] B.A. Levett, *Through the Customs Maze* (New York: Customs Maze Publishing, 1923), p. 11.

[2] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, 12 April 1979, MTN/NTM/W/229/Rev. 1.

[3] Andrew Shonfield, "The Politics of the Mixed Economy in the International System of the 1970s," *International Affairs* 56 (January 1980), p. 8.

[4] *Ibid.*, p. 10.

[5] Gilbert R. Winham, "Robert Strauss, the MTN, and the Control of Faction," *Journal of World Trade Law* 14 (1980), p. 379

[6] For example, Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970), pp. 1–16; Robert Hudec, "GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade," *Yale Law Journal* 80 (June 1971): 1299–1386.

[7] General Agreement on Tariffs and Trade, *opened for signature* 29 October 1947, Art. VII, T.I.A.S. No. 1700, 55 U.N.T.S. 187. Article VII requires that valuation methods be reasonably related to ascertaining the "actual value" of the goods subject to customs duties. "Actual value" is defined as the price at which an item is sold in the ordinary course of trade at places and times specified by the importing country's legislature. *Ibid.*, paragraphs 2(a), (b). If the "actual value" of an item is not amenable to calculation, Article VII permits valuation on the "nearest ascertainable equivalent." *Ibid.*, paragraph 2(c).

[8] See, for example, GATT, *The Tokyo Round of Multilateral Trade Negotiations* (Geneva: 1979), pp. 67–72.

[9] League of Nations, International Conference on Customs and Other Similar Formalities, *Proceedings*, Vol. 1, p. 135, cited in G.A. Elliot, *Tariff Procedures and Trade Barriers* (Toronto: University of Toronto Press, 1955), pp. 7–8.

[10] Customs Act, R.S.C. 1970, Chapter C–40, section 41(1).

[11] Two useful articles are Saul L. Sherman, "Reflections on the New Customs Valuation Code," *Law and Policy in International Business* 12 (1980): 119–58 and Lawrence B. Behrendt, "Technical Analysis of the Customs Valuation Agreement," *Law and Policy in International Business* 12 (1980): 159–76.

[12] Article 2:1 governs the treatment of "identical goods," while Article 3:1 applies the same rule to transactions involving "similar goods." These terms are defined in Article 15.

[13] Article 6(2) of the code provides that "No party may require or compel any person not resident in its own territory to produce for examination, or to allow access to, any account or other record for the purposes of determining a computed value."

[14] Article 15:2(b) defines "similar goods" as goods that "... although not alike in all respects, have like characteristics which enable them to perform the same functions, and to be commercially interchangeable."

[15] Article 14 of the code provides that "the notes at Annex 1 to this Agreement form an integral part of this Agreement. ..."

[16] See, for example, Organisation for Economic Co-operation and Development, Committee on Fiscal Affairs, *Transfer Pricing and Multinational Enterprises* (Paris: 1979) pp. 6–9.

[17] Caroline Pestieau, "Customs Valuation Procedures and Practices," in Klaus Stegemann, *Canadian Non-Tariff Barriers to Trade* (Montreal: Private Planning Association of Canada, Canadian Economic Policy Committee, 1973), p. 136.

[18] *Ibid.*

[19] See Michael Carsella, "Customs Valuation and the Declining Dollar," *Law and Policy in International Business* 10 (1978): 1339–56.

[20] Robert E. Hudec, *Adjudication of International Trade Disputes* (London: Trade Policy Research Centre, 1978), p. 3.

[21] *Ibid.*, p. 2.

[22] *Ibid.*, pp. 36–40.

[23] Address by Ambassador Warren to the Executive Symposium of the Canadian Organization for the Simplification of Trade Procedures (COSTPRO), Ottawa, 14 May 1979. The "Canadian Reservation" was signed on 17 December 1979, and reads:

> Notwithstanding articles 24 and 25 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (hereinafter referred to as the Valuation Agreement) Canada will implement the Valuation Agreement no later than January 1, 1985 provided that before that date there has been agreement under Article XXVIII of the GATT on such adjustments in Canadian tariff rates as may be needed to maintain tariff protection at the levels that would prevail were Canada not to implement the Valuation Agreement.

[24] See Thomas B. Akin, "The Customs Valuation Agreement in the New GATT and Its Effect on Valuation of Imports into Canada," *Canadian Business Law Journal* 4 (1979–80), pp. 344–45.

[25] Department of Finance, "Draft Amendments to the Customs Act: Value for Duty," (Ottawa: August 1980).

[26] Customs Simplification Act of 1956, Pub. L. No. 84–927, § 6, 70 Stat. 943; 19 U.S.C. § 1402 (1976).

[27] For the "Final List" see T.D. 54521, 93 TREAS. 14 December (1958); see, generally, Ruth Strum, *A Manual of Customs Law* (New York: American Importers' Association Inc., 1974), pp. 40–42, 108–15.

[28] 19 U.S.C. §§ 1336(b), 1401 (a)(4), (e), 1402 (a)(4), (g) (1976); see John Evans, *The Kennedy Round in American Trade Policy: The Twilight of the GATT?* (Cambridge, Mass.: Harvard University Press, 1971), pp. 147–51.

[29] 19 U.S.C. § 1401 (a) (3) (1976).

[30] See, for example, Eugene T. Rossides, *U.S. Customs Tariffs and Trade* (Washington, D.C.: Bureau of National Affairs, 1977), pp. 124–27.

[31] *Ibid.*, pp. 128–30.

[32] The U.S. implementing legislation came into force on 1 July 1980. The Trade Agreements Act of 1979, Pub. L. No. 96–39, title II, §§ 201–204, 221–225, 93 Stat. 144 (to be codified in scattered sections of 19 U.S.C.).

[33] This is the case in both Canada and the United States. See Philip Slayton and John Quinn, *The Tariff Board*, study prepared for the Law Reform Commission of Canada (Ottawa: Minister of Supply and Services Canada, 1981), pp. 109–11; U.S. Tariff Commission, *Report on Customs Valuation*, 93rd Cong., 1st sess., 1974, pp. 88–97.

[34] For Canada, see Slayton and Quinn, *op. cit.*, p. 14; for the United States, see Rossides, *op. cit.*, pp. 399– 423, 521 and following.

[35] See Peter M. Gerhart, "Judicial Review of Customs Service Actions," *Law and Policy in International Business* 9 (1977), pp. 1117–20.

[36] *Ibid.*, pp. 1120–21.

[37] Saul Sherman has argued that Article 16 of the code should specify the precise stage or stages in the process when written reasons may be requested. He notes: "The danger is that the request will be required at the time of entry [of the goods], so that every importer will automatically request an explanation. As a result, perfunctory, mass-produced, unenlightening "explanations" would be generated routinely by Customs, burdening Custom House teams and benefiting no one." Sherman, *op. cit.*, pp. 154–55.

[38] See Slayton and Quinn, *op. cit.*, p. 111.

[39] See, for example, *Re Creative Shoes Ltd. et al and M.N.R.* (1972), 29 D.L.R. (3d) 89, [1972] F.C. 993, *leave to appeal denied*, 31 D.L.R. (3d) 330, [1972] S.C.R.X.

[40] See Gerhart, *op. cit.*, pp. 1169–73.

[41] See, for example, *Hayes-Sammons Chemical Co.* v. *United States*, 55 C.C.P.A. 69 (1968); *Minkap of California, Inc.* v. *United States*, 55 C.C.P.A. 1 (1967).

[42] See Tariff Act of 1930, 19 U.S.C. § 1500 (a) (1976).

[43] Gerhart, *op. cit.*, p. 1116 and note 51.

[44] See Tariff Act of 1930, 28 U.S.C. 2634, as amended (1976); Strum, *op. cit.*, pp. 20–21.

[45] Slayton and Quinn, *op. cit.*, pp. 118–21.

[46] For a discussion of the Canadian Tariff Board's procedure for the protection of confidential information, see Slayton and Quinn, *op. cit.*, pp. 48–50.

[47] See Richard J. O'Brien, "Anachronism Laid to Rest: Customs Reform Act Accomplishes Long Overdue Reform of Section 592 of the Tariff Act of 1930," *Law and Policy in International Business* 10 (1979): 1305–24.

Glossary

AFNOR	Association française de normalisation
ASTM	American Society for Testing and Materials
BSI	British Standards Institution
CEN	European Committee for Standards Co-ordination
CENELEC	European Committee for Electrotechnical Co-ordination
CERTICO	ISO Council Committee on Certification
DISC	Domestic International Sales Corporation
EC	European Community
EEC	European Economic Community
EFTA	European Free Trade Association
GATT	General Agreement on Tariffs and Trade
GNP	Gross National Product
IBRD	International Bank for Reconstruction and Development
ICJ	International Court of Justice
IEC	International Electrotechnical Commission
IMF	International Monetary Fund
ISO	International Organization for Standardization
ITC	International Trade Commission
LDC	Less developed country
MTN	Multilateral Trade Negotiations
NTB	Non-tariff barriers
OECD	Organisation for Economic Co-operation and Development (formerly OEEC)
OEEC	Organisation for European Economic Co-operation (later OECD)
OPEC	Organization of Petroleum Exporting Countries
UNCTAD	United Nations Conference on Trade and Development
U.S.C.A.	United States Code Annotated

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